

Legislative Audit Division

State of Montana



Report to the Legislature

December 1996

Financial-Compliance Audit For the Fiscal Year Ended June 30, 1996

Board of Investments

Department of Commerce

We issued unqualified opinions on the financial statements of the Board of Investment's Short-Term Investment Pool, Retirement Funds Bond Pool, Trust Funds Bond Pool, Montana Stock Pool, Montana Convertible Securities Pool, All Other Funds, and Enterprise Fund.

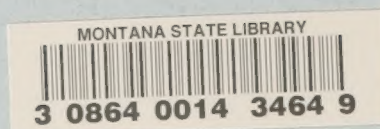
This report contains no recommendations.

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FINANCIAL-COMPLIANCE AUDITS

Financial-compliance audits are conducted by the Legislative Audit Division to determine if an agency's financial operations are properly conducted, the financial reports are presented fairly, and the agency has complied with applicable laws and regulations. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States General Accounting Office. Financial-compliance audit staff members hold degrees with an emphasis in accounting. Most staff members hold Certified Public Accountant (CPA) certificates.

Government Auditing Standards, the Single Audit Act of 1984 and Amendments of 1996, and OMB Circular A-128 require the auditor to issue certain financial, internal control, and compliance reports. This individual agency audit report is not intended to comply with these reporting requirements and is therefore not intended for distribution to federal grantor agencies. The Legislative Audit Division issues a statewide biennial Single Audit Report which complies with the above reporting requirements. The Single Audit Report for the two fiscal years ended June 30, 1995 has been issued. Copies of the Single Audit Report can be obtained by contacting:

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State Capitol
Helena MT 59620
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LEGISLATIVE AUDIT DIVISION

December 1996


The Legislative Audit Committee
of the Montana State Legislature:

This is our financial-compliance audit report on the Board of Investments, Department of Commerce, for the fiscal year ending June 30, 1996. We performed this annual audit of the Board of Investments in compliance with Article VIII, section 13 of the Montana Constitution, and section 17-6-321, MCA. This report contains no recommendations.

We thank the Board of Investment's staff for their cooperation and assistance throughout the audit.

Respectfully submitted,

A handwritten signature in dark ink, appearing to read "Scott A. Seacat".
Scott A. Seacat
Legislative Auditor



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Legislative Audit Division

Financial-Compliance Audit

For the Fiscal Year Ended June 30, 1996

Board of Investments

Department of Commerce

Members of the audit staff involved in this audit were Pete Brustkern, John Fine, Jeane Carstensen-Garrett, Tori Hunthausen, Cindy Jorgenson, Wayne Kedish, and Vickie Murphy.

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Appointed and Administrative Officials

Board of Investments

		<u>Term Expires</u>
Warren Vaughan, Chairman	Billings	1/97
Troy McGee, Sr.	Helena	1/97
Bill Price	Lewistown	1/97
Sharon Walker	Helena	1/97
James Cowan	Seeley Lake	1/97
Maureen Fleming	Missoula	1/99
Lee Robinson	Malta	1/99
Douglas Bardwell	Missoula	1/99
Calvin Wilson	Busby	1/99

Administrative Officials

Carroll South	Executive Director
James R. Penner	Chief Investment Officer
Gayle L. Moon	Accounting Fiscal Manager

Board of Investments

This audit report is the result of our financial-compliance audit of the Board of Investments, Department of Commerce for the fiscal year ending June 30, 1996. We issued unqualified opinions on the following set of financial statements included in this report; Short-Term Investment Pool, Retirement Funds Bond Pool, Trust Funds Bond Pool, Montana Stock Pool, Montana Convertible Securities Pool, All Other Funds, and the Enterprise Fund. An unqualified opinion means the reader may rely on the presented financial information. The report contains no recommendations to the Board of Investments.

Introduction

Introduction

We performed a financial-compliance audit of the Montana Board of Investments' (board) investment and economic development activities for the fiscal year ended June 30, 1996. Article VIII, section 13, of the Montana Constitution requires an annual audit of the board and this report represents compliance with the annual audit requirement. The objectives of the audit were to:

1. Determine if the board complied with applicable laws and regulations.
2. Review the board's management and investment accounting control systems and make recommendations for improvements.
3. Determine if the board's financial statements fairly present, in conformity with generally accepted accounting principles (GAAP), the financial position and results of operations of the board for the fiscal year ended June 30, 1996.
4. Determine the implementation status of the prior audit recommendations.

Background

The board, originally created in 1971, is attached to the Department of Commerce for administrative purposes. The board consists of nine members appointed by the governor and confirmed by the Senate.

The board employs an executive director and an investment officer who in turn hire and manage board staff. The staff members advise the board, implement its decisions, and perform daily investment, economic development and recordkeeping functions. Board personnel recover the cost of administering and accounting for each investment fund's activity by deducting an administrative charge from each fund's investment income.

The board directs the investment of state funds in accordance with the constitution and laws of the state. The board administers the investment program under the "prudent expert principle" which requires an investment manager to:

Introduction

1. Discharge his duties with the care, skill, prudence, and diligence, under the circumstances prevailing, that a prudent person in a like capacity with the same resources and familiarity exercises.
2. Diversify the holdings of each participating fund to minimize the risk of loss and to maximize the rate of return.
3. Discharge his duties solely in the interest of and benefit for the funds forming the unified investment program.

Investment Management Programs

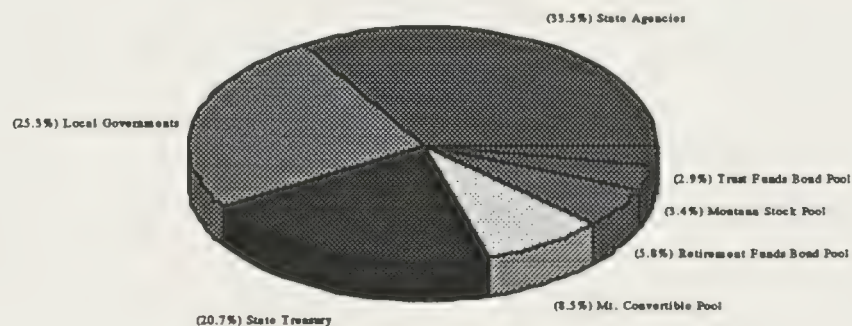
There are six major investment management programs within the board's operations.

Short-Term Investment Pool

The "Short-Term Investment Pool" (STIP) provides a short-term investment vehicle to state or local government investors. Shares are fixed at \$1 and participants may purchase partial shares. The purpose of STIP is to provide the highest possible return, yet maintain a highly liquid position. The short-term investment portfolio is managed by the board, and participants may purchase or sell units on a daily basis. Income is distributed to participants on the first day of each month. Ownership of STIP is shown in the following figure 1.

Figure 1

Short Term Investment Pool
Ownership Percentage
June 30, 1996 Balance = \$1,187,163,319

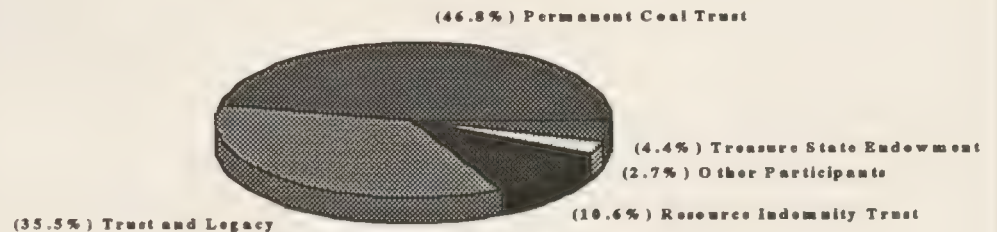


Trust Funds Bond Pool

The "Trust Funds Bond Pool" (TFBP) is an investment pool designed to allow qualifying funds to participate in a diversified pool. On October 1, 1995, all fixed income and variable-rate securities owned by the Coal Severance Tax Permanent Trust, Resource Indemnity Trust, Coal Tax Park Trust, Trust and Legacy, Coal Tax Cultural Trust, and Treasure State Endowment Trust funds held in "All Other Funds"(AOF) were transferred to TFBP. In addition, the University of Montana Endowment Fund became a pool participant on March 1, 1996 and the Department of Natural Resources' Coal Severance Tax School Bond Contingency Fund joined the pool on March 1, 1996. The percent ownership in TFBP is shown in the following figure.

Figure 2

Trust Funds Bond Pool
Ownership Percentage
June 30, 1996 Balance = \$850,970,143



Introduction

Montana Stock Pool

The "Montana Stock Pool" (MTCP) is an investment pool designed to allow authorized agencies to participate in the equity market through a diversified pool. The Montana Constitution authorizes only retirement funds and endowment funds to invest in private corporate capital stock. Cash dividends are distributed monthly to pool participants, while all capital gains and losses are retained by the pool.

Figure 3

Montana Stock Pool
Ownership Percentage
June 30, 1996 Balance = \$1,320,537,965

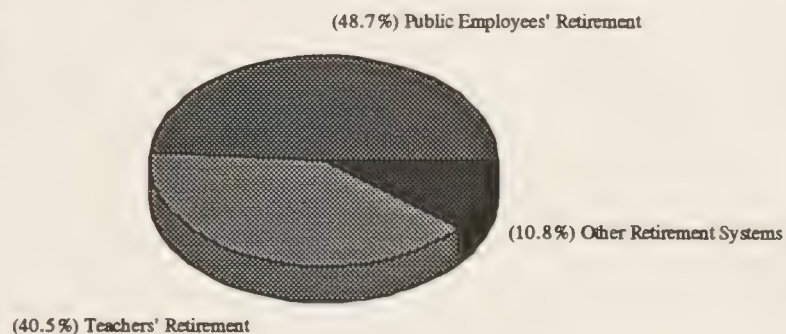


Retirement Funds Bond Pool

The "Retirement Funds Bond Pool" (RFBP) is an investment pool designed to allow the pension funds to participate in a diversified pool. On April 1, 1995, all fixed-income and variable-rate securities held by the nine state administered pension funds were transferred to RFBP. The gains and losses from the pool are distributed to the participants.

Figure 4

Retirement Funds Bond Pool
Ownership Percentage
June 30, 1996 Balance = \$1,722,340,803



Montana Convertible Pool

The "Montana Convertible Pool" (MTCVP) allows participants to invest in convertible securities. The owner of a convertible security has the right to exchange that security for other securities of the issuer or of another issuer. On March 1, 1993, all convertible debt securities held in AOF were transferred to MTCVP. In June 1996, MTCVP securities were sold and the proceeds were invested in STIP at June 30, 1996. Approximately \$44 million of MTCVP was purchased by MTCP. Subsequent to year-end, all MTCVP units were distributed to participants. At dissolution, PERS held 50 percent and TRS held 50 percent of MTCVP. This pool was terminated due to poor performance.

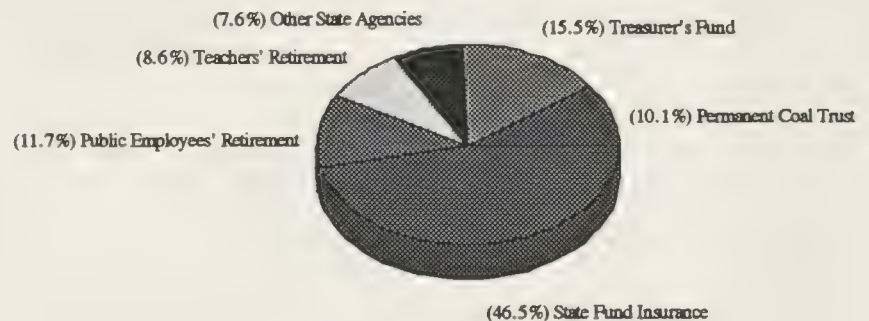
Introduction

All Other Funds

“All Other Funds” (AOF) is a combination of approximately 30 agencies’ investments which the board manages on their behalf. The investments, generally long-term in nature, are managed to produce steady yields over a long period of time. The figure below indicates the percentage of the individual funds’ portfolio to the total AOF portfolio presented in the financial statements.

Figure 5

All Other Funds
Percentage of Individual Funds’ Portfolio
June 30, 1996 Combined Portfolio Balance = \$1,034,006,169



Economic Development Programs

According to the objectives outlined in state law, the board administers economic development programs created for the purpose of strengthening, diversifying, stabilizing the Montana economy and increasing Montana employment and business opportunities. The following paragraphs describe these programs.

Mortgage Loan Program

The Mortgage Loan Program invests public moneys in Montana through purchase of mortgage loans. There are five types of mortgages purchased under this program: conventional residential, Federal Housing Administration guaranteed residential, Veterans' Administration guaranteed residential, conventional multifamily, and commercial buildings. Applications are reviewed by the board using Federal Home Loan Mortgage Corporation standards. This activity is included in the "All Other Funds" financial statements.

Coal Tax Loan Program

The Coal Tax Loan Program invests up to 25 percent of the Permanent Coal Tax Trust Fund in the Montana economy by purchasing loans from approved financial institutions. There are three types of loans purchased under this program: *The Federal Guaranteed Loan Program*, funds small business loans by purchasing the guaranteed portion of federally backed loans; *The Business Loan Participation Program*, funds small business loans by purchasing up to 80% of the loan amount from originating financial institutions; and *The Economic Development Linked Deposit Program*, offers businesses long-term, fixed rate financing for working capital, inventory, or real property. The Coal Tax loans are included in the "All Other Funds" financial statements.

Economic Development Bond Program

The purpose of the Economic Development Bond program is to increase job opportunities and retain existing jobs by making funds available for development of industrial, commercial, manufacturing, natural resource, agricultural, livestock, recreational, tourism, and health care industries. The following paragraphs describe the bond programs established to meet this objective.

Pooled Economic Development Bond Program

This program provided businesses satisfying program requirements with access to the tax-exempt bond market. The Pooled Program is currently inactive due to changes in federal tax law passed in 1986. Board officials believe the Pooled Program can no longer provide useful financing, so there are no plans for issuing further bonds under the program. Approximately \$630,000 of debt existed at June 30, 1996 from previous bond issues.

Introduction

Montana Conservation Reserve Payment (CRP) Enhancement Program

This program allows farmers to receive a lump sum amount in return for assignment of their federal CRP contract to the board. Total bond anticipation notes outstanding at June 30, 1996, were approximately \$3.3 million.

Municipal Finance Consolidation Act Program

The purpose of the Municipal Finance Consolidation Act program is to reduce marketing and interest costs and to provide additional security for the debt instruments of government units by creating a means for pooling those debt instruments. The following paragraphs describe the bond programs established to meet this objective.

Intermediate Term Capital Program (INTERCAP)

This program finances intermediate term (one to ten years) capital needs of local governments or the university system by lending for vehicles, equipment and property improvements. The board pools borrowing needs of various local governments and issues bonds to finance these projects. Local government participants pay the cost of issuance. The board issued \$7.5 million in bonds under this program in fiscal year 1995-96. Approximately, \$26 million of debt existed at June 30, 1996.

Pooled Irrigation Loan Program

This program allowed certain Montana irrigation districts to take advantage of a federal government offer to prepay outstanding Bureau of Reclamation loans at a substantial discount. Approximately \$4.5 million of debt existed at June 30, 1996 from the program's previous bond issuance.

School District Pool Refunding Program

Under this program, participating school districts may refinance their outstanding general obligation bonds to lower interest costs. The board did not issue bonds under this program in fiscal year 1995-96. Approximately \$3.3 million of debt was outstanding at June 30, 1996 from previous bond issuance.

Additional information concerning bonds issued by the board appears in the Enterprise Fund financial statements on pages G-5 through G-16.

Additional Bond Programs

The board administers two additional bond programs which are not included in the Enterprise Fund financial statements because the bond issuances do not constitute an obligation of the board. The following paragraphs describe these bond programs.

No-Commitment Debt Program

This program allows certain businesses to obtain money by issuing tax-exempt stand-alone industrial development bonds. Under this program, the board does not extend, either directly or indirectly, credit or funds to program users but serves as the legal conduit into the tax-exempt bond market. The board did not issue bonds under this program during fiscal year 1995-96. Stand-alone bonds are not liabilities of the state of Montana because assets and revenues of private companies are pledged to repay the bonds.

Payroll Tax Bonds

The board issued payroll tax bonds for the purpose of funding the cost of paying and administering claims related to the unfunded liability of the Workers' Compensation Program. The bonds are payable from Old Fund liability tax revenues collected by the Department of Revenue. The debt is reflected on the financial statements of the State Compensation Insurance Fund.

Prior Audit Recommendations

Prior Audit Recommendations

Our prior audit report, issued for the fiscal year 1993-94, contained eight recommendations. The board implemented all eight recommendations.

**Independent Auditor's Report &
Short-Term Investment Pool
Financial Statements**

MONTANA LEGISLATIVE BRANCH

Legislative Auditor
Scott A. Seacat

Legal Counsel:
John Northey



Deputy Legislative Auditors:
Mary Bryson
Operations and EDP Audit
James Gillett
Financial-Compliance Audit
Jim Pellegrini
Performance Audit

LEGISLATIVE AUDIT DIVISION

INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the accompanying Statement of Net Asset Value for the state of Montana Board of Investments, Short-Term Investment Pool, as of June 30, 1996 and 1995, and the related Statement of Changes in Net Asset Value and Statement of Investment Income and Distribution for the two fiscal years then ended. These financial statements are the responsibility of the Board of Investments' management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net asset value of the state of Montana Board of Investments, Short-Term Investment Pool, as of June 30, 1996 and 1995, and its changes in net asset value and investment income and distributions for the fiscal years then ended in conformity with generally accepted accounting principles.

Respectfully submitted,

A handwritten signature in cursive script that reads "James Gillett".

James Gillett, CPA
Deputy Legislative Auditor

October 4, 1996

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**STATE OF MONTANA BOARD OF INVESTMENTS
SHORT TERM INVESTMENT POOL FINANCIAL STATEMENTS**

STATEMENT OF NET ASSET VALUE, JUNE 30, 1996 AND 1995

	<u>1996</u>	<u>1995</u>
<u>Assets</u>		
Cash	\$ 0	\$ 250,671
Interest receivable	9,705,588	4,127,740
Broker receivable for securities sold but not settled (Note 2)	0	25,000,000
Investments managed at market value (amortized cost of \$1,187,910,678 in 1996 and \$856,519,667 in 1995) (Notes 2 and 4)	<u>1,187,163,319</u>	<u>857,099,547</u>
Total assets	<u>1,196,868,907</u>	<u>886,477,958</u>
<u>Liabilities</u>		
Broker payable for securities purchased but not settled (Note 2)	9,939,778	0
Income due participants	666,431	4,616,438
Unrealized gain (loss) (Note 2)	(747,358)	579,880
Due to other funds	<u>1,012,329</u>	<u>0</u>
Total liabilities	<u>10,871,180</u>	<u>5,196,318</u>
Net asset value	<u>\$1,185,997,727</u>	<u>\$881,281,640</u>
Units Outstanding	1,185,997,727	881,281,640
Unit Value	\$1	\$1

**STATEMENT OF CHANGES IN NET ASSET VALUE
FOR THE FISCAL YEARS ENDED JUNE 30, 1996 AND 1995**

Net asset value, beginning of year	\$ 881,281,640	\$ 851,043,200
Value of units purchased by participants	4,518,915,996	3,758,248,794
Value of units sold by participants	<u>(4,214,199,909)</u>	<u>(3,728,010,354)</u>
Net asset value, end of year	<u>\$1,185,997,727</u>	<u>\$ 881,281,640</u>

**STATEMENT OF INVESTMENT INCOME AND DISTRIBUTION
FOR THE FISCAL YEARS ENDED JUNE 30, 1996 AND 1995**

Investment income	\$ 53,899,905	\$ 47,348,337
Administrative expenses	(428,535)	(527,643)
Income due participants, beginning of year	<u>4,616,438</u>	<u>964,505</u>
Income available for distribution	58,087,808	47,785,199
Distribution	<u>57,421,377</u>	<u>43,168,761</u>
Income due participants, end of year	\$ <u>666,431</u>	\$ <u>4,616,438</u>

The accompanying notes are an integral part of these financial statements.

STATE OF MONTANA BOARD OF INVESTMENTS
SHORT TERM INVESTMENT POOL - NOTES TO FINANCIAL STATEMENTS

JUNE 30, 1996 AND 1995

1. HISTORY AND ORGANIZATION

The Board was created by an act of the Legislature to invest and manage the State of Montana's investment funds on a centralized basis. The Short Term Investment Pool (STIP) was created by the Board to allow qualifying funds, per Sections 17-6-201, 202 and 204, MCA, to participate in a diversified pool. The purpose of STIP is to obtain the highest possible return, yet maintain a highly liquid position whereby funds may be invested for relatively short periods, one day or more, depending upon the participant's anticipated use of the funds. The investments and the income from STIP are owned by the participants, as they purchase units, and are managed on their behalf by the Board.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Investments

STIP investments are purchased in accordance with the statutorily mandated "Prudent Expert Principle". The STIP portfolio includes asset-backed securities, banker's acceptances, certificates of deposit, commercial paper, corporate and government securities, repurchase agreements and variable-rate (floating-rate) instruments. These securities are purchased to provide shareholders with a diversified portfolio earning a competitive total rate of return.

Asset-backed securities represent debt securities collateralized by a pool of non-mortgage assets such as trade and loan receivables, equipment leases, credit cards, etc. Banker's acceptances, as money market instruments, are defined as discounted time drafts drawn on and accepted by a bank. Commercial paper is unsecured short term debt with maturities ranging from 1 to 270 days. Commercial paper, issued at a discount, direct or by brokers, is backed by bank credit lines. Repurchase agreements (REPOs) represent an agreement between a seller and a buyer, usually of U.S. government securities, whereby the seller agrees to repurchase the securities at an agreed upon price and stated time. Variable-rate (floating-rate) securities pay a variable rate of interest until maturity. The variable-rate securities float with the prime rate and LIBOR (London Interbank Offered Rate). (See Note 4 on Investment Risk Categories and Note 5 for the Year End Portfolio.)

Investments held are reported at market value based on market prices supplied to the Board by various pricing services. The difference between amortized cost and market value is reflected as an unrealized gain or loss in the investments managed. The STIP investment portfolio consists of securities with a maximum maturity of 397 days or less with the exception of securities having rate reset dates. The portfolio is carried at amortized cost or book value.

Participant Units

The STIP unit value is fixed at \$1. A purchased unit earns income on the purchase date and ceases to earn income on the day before the unit is sold. Participants may buy or sell fractional shares. For fiscal year 1995, income was distributed on the first calendar day of

each month. In fiscal year 1996, income continued to be distributed on the first calendar day of each month with the exception of June 1996. Income for June 1996 was distributed on the last calendar day of the month. Participants may automatically reinvest their income in additional units.

Broker Receivable/Payable

STIP security transactions are recorded as of the trade date rather than the settlement date. Because of this generally accepted practice, the STIP portfolio at June 30 includes receivables from brokers for securities sold but not delivered, and payables to brokers for securities purchased but not received.

Income Due Participants

Income due participants of \$4,616,438 as of June 30, 1995 decreased to \$666,431 as of June 30, 1996 due to distributing the June 1996 income on June 30 rather than July 1.

Other

Administrative expenses incurred by the Board are charged daily to STIP based on the Board's expenses applicable to STIP.

3. SECURITIES LENDING

The Board has an agreement with the custodial bank whereby the bank lends to other entities securities managed by the Board. State Street Bank was appointed the Board's custodial bank on December 1, 1993. During the period the securities are on loan, the Board receives a fee and the bank must maintain collateral equal to 102 percent of the market value of the securities on loan. The Board retains all rights and risks of ownership during the loan period. Securities lending income totaled \$188,792 for the year ended June 30, 1996, and \$111,082 for the year ended June 30, 1995. At June 30, 1996, and June 30, 1995, respectively, \$64,182,770 and \$49,310,126 in securities were on loan to other entities.

4. INVESTMENT RISK CATEGORIES

State of Montana investments are categorized below to give an indication of the level of risk assumed at June 30, 1996 and June 30, 1995. Category 1 includes investments that are insured or registered or securities that are held by the Board or its agent in the Board's name. Category 2 includes uninsured and unregistered investments, with securities held by the counterparty trust department or agent in the Board's name.

Risk as of June 30, 1996

<u>Investment Type</u>	<u>Category 1</u>	<u>Category 2 *</u>	<u>Carrying Amount</u>	<u>Market Value</u>
Asset-Backed Securities	\$ 234,352,045	\$ 0	\$ 234,352,045	\$ 234,329,292
Banker's Acceptances	59,928,689	0	59,928,689	59,920,081
Commercial Paper	35,549,778	0	35,549,778	35,544,668
Corporate Obligations	173,248,181	0	173,248,181	172,890,990
Government Securities	229,474,986	64,182,770	293,657,756	293,248,850
Repurchase Agreements	80,000,000	0	80,000,000	80,000,000
Variable-Rate (Floating-Rate)	<u>311,174,229</u>	<u>0</u>	<u>311,174,229</u>	<u>311,229,438</u>
 Total Investments	 <u>\$1,123,727,908</u>	 <u>\$64,182,770</u>	 <u>\$1,187,910,678</u>	 <u>\$1,187,163,319</u>

Risk as of June 30, 1995

<u>Investment Type</u>	<u>Category 1</u>	<u>Category 2 **</u>	<u>Carrying Amount</u>	<u>Market Value</u>
Asset-Backed Securities	\$ 127,258,945	\$ 0	\$ 127,258,945	\$ 127,254,545
Banker's Acceptances	87,423,514	0	87,423,514	87,414,706
Certificates of Deposit	3,750,000	0	3,750,000	3,750,000
Commercial Paper	152,609,612	0	152,609,612	152,579,793
Corporate Obligations	85,139,171	0	85,139,171	85,371,097
Government Securities	73,304,178	49,060,887	122,365,065	122,776,706
Repurchase Agreements	125,000,000	0	125,000,000	125,000,000
Variable-Rate (Floating-Rate)	<u>152,724,121</u>	<u>249,239</u>	<u>152,973,360</u>	<u>152,952,700</u>
 Total Investments	 <u>\$807,209,541</u>	 <u>\$49,310,126</u>	 <u>\$856,519,667</u>	 <u>\$857,099,547</u>

* At June 30, 1996, these securities with a market value of \$64,053,346 were loaned under a securities lending agreement with the state's agent.

** At June 30, 1995, these securities with a market value of \$49,764,400 were loaned under a securities lending agreement with the state's agent.

STIP investments' credit risk is measured by investment grade ratings given individual securities. Board of Investment's policy requires that STIP investments have the highest rating in the short term category by one and/or any Nationally Recognized Statistical Rating Organizations (NRSRO). The six NRSRO's include Standard and Poors, Moody's, Duff and Phelps, Fitch, IBCA and Thompson's Bank Watch.

Asset-backed securities have less credit risk than do securities not backed by pledged assets, while market risk for asset-backed securities is the same as market risk for similar non asset-backed securities.

While variable-rate securities have credit risk identical to similar fixed-rate securities, their market risk (income) is more sensitive to interest rate changes. However, their market risk (value/price) may be less volatile than fixed-rate securities because their value will usually remain at or near par as a result of their interest rates being periodically reset to maintain a current market yield.

There are no legal risks that the Board is aware of regarding any STIP investments.

During fiscal 1995, STIP held \$25 million in Orange County, California notes. Although Orange County declared bankruptcy on December 6, 1994, the Board received all monthly interest payments and the June 30, 1995 principal maturity of \$25 million as scheduled.

5. YEAR END PORTFOLIO

The June 30, 1996 STIP portfolio is listed below.

STIP PORTFOLIO AS OF JUNE 30, 1996

<u>Security Name</u>	<u>Coupon</u>	<u>Maturity</u>	<u>Par</u>	<u>Book Value</u>	<u>Market Value</u>
CASE EQUIPMENT LOAN TRUST 94 B	5.38	07/15/96	5,000,000	4,989,539	5,000,000
CASE EQUIP LN TR	5.00	02/15/97	13,223,173	13,219,841	13,215,239
FORD CR AUTO OWNER TR 1996 A	5.67	07/15/97	10,000,000	10,000,000	9,976,800
NAVISTAR FINL CORP	5.75	11/15/96	912,165	912,159	912,165
NAVISTAR FINL OWNER TR	5.25	06/15/97	18,475,987	18,469,376	18,488,920
TOTAL ASSET-BACKED NOTES			<u>47,611,325</u>	<u>47,590,915</u>	<u>47,593,124</u>
AML LEASING TRUST	discount	08/29/96	5,812,000	5,760,373	5,759,692
ASI FDG CORP	discount	08/23/96	10,000,000	9,920,058	9,919,000
AESOP FUNDING CORPORATION	discount	07/25/96	5,000,000	4,982,167	4,981,424
ASSET SECURITIZATION COOP CORP	discount	08/06/96	5,000,000	4,972,850	4,972,250
ASSET SECURITIZATION COOP CORP	discount	08/08/96	5,000,000	4,971,342	4,970,609
ASSETS SECURITIZATION COOP	discount	08/02/96	10,000,000	9,952,000	9,950,500
BERKELY FUNDING INC	discount	07/16/96	5,000,000	4,988,813	4,988,111
BERKELY FUNDING INC	discount	07/22/96	10,000,000	9,968,675	9,967,306
CLIPPER RECEIVABLES CORP	discount	07/09/96	5,000,000	4,994,056	4,993,313
DELAWARE GRP DIV + INCOME FD	discount	08/27/96	5,000,000	4,957,013	4,956,500
ENTERPRISE FUNDING CORP	discount	07/23/96	5,000,000	4,983,561	4,982,910
ENTERPRISE FUNDING CORP	discount	08/01/96	5,000,000	4,976,750	4,976,000
FINGERHUT OWNER TR DISC COML	discount	07/11/96	5,000,000	4,992,597	4,991,826
GREENWICH ASSET FUNDING INC	discount	08/22/96	4,642,000	4,605,658	4,605,096
HUDSON FINANCE INC	discount	07/15/96	6,438,000	6,424,555	6,423,649
LYON SHORT TERM FUNDINGCORP	discount	07/08/96	8,227,000	8,218,362	8,217,219
MARKET STR FDG CORP	discount	07/17/96	10,000,000	9,976,089	9,974,736
OLD LINE FUNDING CORP	discount	07/18/96	5,000,000	4,987,368	4,986,625
PREMIUM FUNDING SER A	discount	07/19/96	10,000,000	9,973,100	9,971,764
PREMIUM FUNDING SER A	discount	07/24/96	10,000,000	9,965,628	9,964,333
RECEIVABLES CAPITAL CORP	discount	07/10/96	10,000,000	9,986,700	9,985,139
RECEIVABLES CAPITAL CORP	discount	07/31/96	5,094,000	5,071,162	5,070,532
RECEIVABLES CAPITAL CORP	discount	08/28/96	5,440,000	5,392,321	5,391,856
THAMES ASSET GLOBAL SEC	discount	07/15/96	16,797,000	16,761,596	16,759,557
TRIPLE A ONE FDG CORP	discount	07/02/96	5,000,000	4,999,260	4,998,514
TRIPLE A ONE FDG CORP	discount	07/15/96	10,000,000	9,979,078	9,977,708
TOTAL COM. PAPER ASSET-BACKED			<u>187,450,000</u>	<u>186,761,130</u>	<u>186,736,168</u>
TOTAL ASSET-BACKED SECURITIES			<u>235,061,325</u>	<u>234,352,045</u>	<u>234,329,292</u>
BANK OF TOKYO LA	discount	08/26/96	5,000,000	4,957,533	4,957,646
DAI ICHI KANGYO BANK LTD	discount	07/12/96	8,000,000	7,986,824	7,985,600
DAI ICHI KANGYO NEW YORK	discount	07/03/96	6,100,000	6,098,177	6,097,255
FIRST BANK NATIONAL ASSOC	discount	07/05/96	10,000,000	9,994,167	9,992,639
FIRST BK MINNEAPOLIS	discount	07/03/96	5,000,000	4,998,528	4,997,791

<u>Security Name</u>	<u>Coupon</u>	<u>Maturity</u>	<u>Par</u>	<u>Book Value</u>	<u>Market Value</u>
INDUSTRIAL BK OF JAPAN LTD	discount	07/30/96	5,000,000	4,978,492	4,977,500
SANWA BANK LTD	discount	07/26/96	5,000,000	4,981,424	4,980,500
SANWA BANK LTD	discount	07/29/96	6,000,000	5,974,940	5,973,900
SANWA BANK LTD	discount	07/31/96	5,000,000	4,977,458	4,976,750
SUMITOMO BK LTD	discount	07/26/96	5,000,000	4,981,146	4,980,500
TOTAL BANKER'S ACCEPTANCE			<u>60,100,000</u>	<u>59,928,689</u>	<u>59,920,081</u>
FRANKLIN RESOURCES IN	discount	08/05/96	5,000,000	4,973,653	4,973,000
FRANKLIN RESOURCES IN	discount	08/15/96	5,000,000	4,966,125	4,965,500
RELIASTAR MTG CORP	discount	07/15/96	6,250,000	6,237,094	6,236,068
RELIASTAR MTG CORP	discount	08/07/96	4,500,000	4,475,025	4,474,350
STATE MUTUAL LIFE ASSURANCE	discount	08/19/96	5,000,000	4,963,182	4,962,500
TRIBUNE CO	discount	08/20/96	5,000,000	4,962,500	4,961,750
YORKSHIRE BLDG SOCIETY	discount	08/07/96	5,000,000	4,972,199	4,971,500
TOTAL COMMERCIAL PAPER			<u>35,750,000</u>	<u>35,549,778</u>	<u>35,544,668</u>
BANK HAWAII HONOLULU MTN	5.50	01/03/97	25,000,000	25,018,221	24,946,500
BANKERS TRUST COMPANY	4.70	07/01/96	6,100,000	6,100,000	6,100,000
BANKERS TR NY CORP	4.70	07/01/96	14,000,000	14,000,000	14,000,000
DEERE JOHN CAP CORP	5.95	06/30/97	15,000,000	14,986,015	15,000,000
GENERAL ELEC CAP CORP	5.06	02/03/97	15,000,000	14,995,797	14,936,250
GENERAL ELEC CAP CORP	4.95	02/06/97	15,000,000	14,994,861	14,925,000
GENERAL MTRS CORP	7.63	02/15/97	15,000,000	15,183,334	15,156,000
JOHN HANCOCK CAPITAL MTN	4.60	09/03/96	8,000,000	7,980,794	7,981,040
HARRIS TR + SVGS BK CHICAGO IL	6.04	06/17/97	15,000,000	14,991,443	14,999,250
MELLON BK N A PITTSBURGH PA	5.60	11/07/96	20,000,000	19,999,265	19,969,200
BETA FINANCE CORP	4.95	02/12/97	25,000,000	24,998,452	24,877,750
TOTAL CORPORATE BONDS/NOTES			<u>173,100,000</u>	<u>173,248,181</u>	<u>172,890,990</u>
FEDERAL FARM CR BKS BDS	5.60	07/01/96	5,650,000	5,650,000	5,650,000
FEDERAL HOME LN BKS	5.05	07/01/96	25,000,000	25,000,000	25,000,000
FEDERAL HOME LN BKS	5.08	07/01/96	25,250,000	25,250,000	25,250,000
FED HOME LN BANK	5.25	02/06/97	20,000,000	20,000,000	19,937,400
FEDERAL HOME LN BKS	5.56	03/28/97	20,000,000	20,000,000	19,943,000
FEDERAL HOME LN BKS	5.59	03/28/97	10,000,000	10,000,000	9,979,700
FEDERAL NATL MTG ASSN MTN	5.37	12/18/96	10,000,000	9,993,605	9,992,000
FEDERAL NATL MTG ASSN MTN	5.35	12/26/96	10,000,000	9,992,386	9,995,000
FEDERAL FARM CREDIT BK	5.60	07/01/96	15,000,000	15,000,000	15,000,000
STUDENT LN MARKETING ASSN	6.08	07/01/96	27,795,000	27,795,000	27,795,000
UNITED STATES TREAS NTS	4.75	02/15/97	50,000,000	49,898,731	49,687,500
UNITED STATES TREAS NTS	6.50	04/30/97	15,000,000	15,095,077	15,084,450
UNITED STATES TREAS NTS	6.50	04/30/97	10,000,000	10,069,912	10,056,300
UNITED STATES TREAS NTS	5.63	06/30/97	50,000,000	49,913,045	49,878,500
TOTAL GOVERNMENT SECURITIES			<u>293,695,000</u>	<u>293,657,756</u>	<u>293,248,850</u>
CITIBANK REPURCHASE AGREEMENT	5.40	07/01/96	80,000,000	80,000,000	80,000,000
TOTAL REPURCHASE AGREEMENT			<u>80,000,000</u>	<u>80,000,000</u>	<u>80,000,000</u>
ASSET BACKED TRUST 1996 SA 4	5.53	01/15/97	25,000,000	25,000,790	24,998,750
ASSET BACKED TRUST	5.51	04/15/97	25,000,000	25,000,000	24,998,750
FEDERAL FARM CR BKS CONS SYS	5.20	12/30/96	20,000,000	19,981,941	19,982,000

<u>Security Name</u>	<u>Coupon</u>	<u>Maturity</u>	<u>Par</u>	<u>Book Value</u>	<u>Market Value</u>
FIRST BK SYS INC MEDIUM TERM	5.51	03/19/97	39,240,000	39,257,200	39,238,038
JOHNSON CONTROLS	5.43	06/30/97	15,000,000	14,994,198	14,999,250
M + I MADISON BK MADISON WI	5.55	07/29/96	10,000,000	10,000,388	9,999,500
M + I BK JANESVILLE WI MTN	5.52	09/09/96	15,000,000	15,001,398	14,999,250
NORWEST CORP	5.43	10/28/96	25,000,000	25,000,000	24,998,750
ONTARIO PROV CDA	5.48	08/17/99	40,000,000	39,961,894	40,020,000
PNC BK NA PITTSBURGHPA	5.40	06/06/97	10,000,000	9,995,384	9,999,500
SOUTHTRUST BK ATLANTA GA	5.42	01/10/97	40,000,000	39,994,667	39,998,000
WACHOVIA BK NC N A MTN BK ENT	5.33	04/09/97	22,000,000	21,986,171	21,998,900
WELLS FARGO + CO MTN BK ENTRY	5.58	04/07/97	25,000,000	25,000,198	24,998,750
 TOTAL VARIABLE-RATE(FLOATING-RATE)			<u>311,240,000</u>	<u>311,174,229</u>	<u>311,229,438</u>
 TOTAL STIP INVESTMENTS			<u>\$1,188,946,325</u>	<u>\$1,187,910,678</u>	<u>\$1,187,163,319</u>

**Independent Auditor's Report &
Retirement Funds Bond Pool
Financial Statements**

MONTANA LEGISLATIVE BRANCH

Legislative Auditor
Scott A. Seacat

Legal Counsel:
John Northey



Deputy Legislative Auditors:
Mary Bryson
Operations and EDP Audit
James Gillett
Financial-Compliance Audit
Jim Pellegrini
Performance Audit

LEGISLATIVE AUDIT DIVISION

INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the accompanying Statement of Net Asset Value for the state of Montana Board of Investments, Retirement Funds Bond Pool, as of June 30, 1996 and 1995, and the related Statement of Changes in Net Asset Value and Statement of Investment Income and Distribution for the two fiscal years then ended. These financial statements are the responsibility of the Board of Investments' management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net asset value of the state of Montana Board of Investments, Retirement Funds Bond Pool, as of June 30, 1996 and 1995, and its changes in net asset value and investment income and distributions for the fiscal years then ended in conformity with generally accepted accounting principles.

Respectfully submitted,

A handwritten signature in cursive script, appearing to read "James Gillett".

James Gillett, CPA
Deputy Legislative Auditor

October 4, 1996

**STATE OF MONTANA BOARD OF INVESTMENTS
RETIREMENT FUNDS BOND POOL FINANCIAL STATEMENTS**

STATEMENT OF NET ASSET VALUE JUNE 30, 1996 AND 1995

	<u>1996</u>	<u>1995</u>
<u>Assets</u>		
Cash	\$ 0	\$ 1,000
Interest receivable	32,351,671	23,296,966
Investments managed at current value (amortized cost of \$1,702,643,530 in 1996 and \$1,581,846,819 in 1995) (Notes 2 and 4)	<u>1,722,340,803</u>	<u>1,649,713,066</u>
Total assets	\$ <u>1,754,692,474</u>	\$ <u>1,673,011,032</u>
<u>Liabilities</u>		
Income due participants (Note 2)	<u>11,320,128</u>	<u>10,876,292</u>
Total liabilities	<u>11,320,128</u>	<u>10,876,292</u>
Net asset value	\$ <u>1,743,372,346</u>	\$ <u>1,662,134,740</u>
Units Outstanding	17,110,138	15,862,230
Unit Value	\$101.89	\$104.79

**STATEMENT OF CHANGES IN NET ASSET VALUE
FOR THE FISCAL YEAR ENDED JUNE 30, 1996 AND 1995**

Net asset value, beginning of year	\$ 1,662,134,740	\$ 0
Value of units purchased by participants	129,406,579	1,594,268,494
Value of units sold by participants	0	0
Changes in current value of investments managed	<u>(48,168,973)</u>	<u>67,866,246</u>
Net asset value, end of year	<u>\$1,743,372,346</u>	<u>\$1,662,134,740</u>

**STATEMENT OF INVESTMENT INCOME AND DISTRIBUTION
FOR THE FISCAL YEARS ENDED JUNE 30, 1996 AND 1995**

Investment income (Note 2)	\$ 139,604,982	\$ 31,863,835
Administrative expenses	(215,118)	(69,021)
Income due participants, beginning of year	<u>10,876,292</u>	<u>0</u>
Income available for distribution	<u>150,266,156</u>	<u>31,794,814</u>
Distribution	<u>138,946,028</u>	<u>20,918,522</u>
Income due participants, end of year (Note 2)	\$ <u>11,320,128</u>	\$ <u>10,876,292</u>

The accompanying notes are an integral part of these financial statements.

**STATE OF MONTANA BOARD OF INVESTMENTS
RETIREMENT FUNDS BOND POOL**

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 1996 AND 1995**

1. HISTORY AND ORGANIZATION

The Board was created by an act of the Legislature to invest and manage the State of Montana's investment funds on a centralized basis. The Retirement Funds Bond Pool (RFBP) was created by the Board to allow qualifying funds, per Section 17-6-201, MCA, to participate in a diversified pool. The RFBP was created as of April 1, 1995 by the transfer of all fixed income and variable-rate securities owned by the Public Employees', Municipal Police Officers', Game Wardens', Sheriffs', Judges', Highway Patrol Officers', Teachers', Volunteer Firefighters' and Firefighters' Unified retirement funds.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Investments

RFBP investments are purchased in accordance with the statutorily mandated "Prudent Expert Principle". The RFBP portfolio includes corporate asset-backed, other corporate, U.S. government mortgage-backed, U.S. government and yankee securities. Corporate asset-backed securities represent debt securities collateralized by a pool of assets. U.S. government mortgage-backed securities reflect participation in a pool of residential mortgages. U.S. government securities include direct and indirect obligations of the U.S. Treasury. Yankee bonds are U.S. dollar denominated bonds issued by foreign corporations and governments and U.S. companies issuing debt in foreign markets.

The RFBP portfolio includes structured financial instruments known as REMICs (Real Estate Mortgage Investment Conduits). REMICs are pass-through vehicles for multiclass mortgage-backed securities. Some RFBP REMICs are principal-only strips (POs) and interest-only strips (IOs). Strip investments represent the separate purchase of the principal and interest cash flows of a mortgage security. POs receive cash flow from the principal payment component while IOs receive cash flow from the interest payment component on underlying mortgage loans. These securities, purchased for portfolio diversification and a competitive rate of return, are identified and reported as government mortgage-backed securities in the investment risk and portfolio disclosures. (See Note 4 on Investment Risk Categories and Note 5 for the Year End Portfolio.)

RFBP fixed income securities pay a fixed rate of interest until maturity while the variable-rate (floating-rate) securities pay a variable interest rate until maturity. The variable-rate securities float with LIBOR (London Interbank Offered Rate) or the weighted average of the net mortgage interest rates for the mortgage loan group. The four variable-rate securities, with an amortized cost of \$4,300,568 and \$4,338,676, respectively as of June 30, 1996 and 1995, and are identified and reported as corporate asset-backed and government mortgage-backed securities in the investment risk and portfolio disclosures. (See Note 4 on Investment Risk Categories and Note 5 for the Year End Portfolio.)

Investments are presented in the Statement of Net Asset Value at current value. Current values are determined primarily by reference to market prices supplied to the Board by the Board's custodial bank, State Street Bank. Amortized cost, parenthetically disclosed, represents the original cost, adjusted for premium and discount amortization where applicable. Premiums and discounts are amortized/accreted using the straight-line or interest method to the call, average life or maturity date of the securities.

Participant Units

The Public Employees', Municipal Police Officers', Game Wardens', Sheriffs', Judges', Highway Patrol Officers', Teachers', Volunteer Firefighters' and Firefighters' Unified retirement funds transferred all fixed income and variable-rate securities, at amortized cost, into the RFBP at the start-up date and were issued units according to the market value of each participant's portfolio. The initial unit value as of April 1, 1995 was \$100.00. Unit values thereafter are calculated weekly, based on portfolio pricing, to allow for participant transactions to occur as determined by the investment officer.

The June 30, 1995 unit value was restated from \$105 to \$104.79 to reflect the unit value pricing at two decimal places.

Other

Accumulated income, recorded as Income Due Participants, is distributed monthly on the first calendar day of each month. Realized portfolio gains/losses are distributed at least annually to the participants.

Investment income reported in the Statement of Investment Income and Distribution includes interest accruals, security lending income, realized gains/losses, amortization/accretion and miscellaneous income. The RFBP income for fiscal year 1995 reflects income earned by the pool for three months from April 1, 1995 to June 30, 1995.

3. SECURITIES LENDING

The Board has an agreement with the custodial bank, State Street Bank, whereby State Street Bank lends to other entities securities managed by the Board. During the period the securities are on loan, the Board receives a fee and State Street Bank must maintain collateral equal to 102 percent of the market value of the securities on loan. The Board retains all rights and risks of ownership during the loan period. Securities lending income was \$707,393 for fiscal year 1996 and \$144,589 for fiscal year 1995. On June 30, 1996 and 1995, respectively, \$355,479,222 and \$414,133,990 in securities were on loan to other entities.

4. INVESTMENT RISK CATEGORIES

State of Montana investments are categorized below to give an indication of the level of risk assumed at June 30, 1996 and June 30, 1995. Category 1 includes investments that are insured or registered, or securities that are held by the Board or its agent in the Board's name. Category 2 includes uninsured and unregistered investments, with securities held by the counterpart trust department or agent in the Board's name.

Risk as of June 30, 1996

<u>Investment Type</u>	<u>Category 1</u>	<u>Category 2*</u>	<u>Carrying Amount</u>	<u>Market Value</u>
Corporate Asset-Backed	\$ 91,333,835	\$ 0	\$ 91,333,835	\$ 91,511,108
Corporate Other	819,745,156	15,367,299	835,112,455	848,318,621
US Govt Mortgage-Backed	115,757,459	0	115,757,459	117,302,329
US Govt Direct/Indirect	144,520,306	338,836,401	483,356,707	485,182,209
Yankee Bonds	107,466,145	1,275,522	108,741,667	111,685,129
STIP	68,341,407	0	68,341,407	68,341,407
Total Investment	\$ 1,347,164,308	\$ 355,479,222	\$ 1,702,643,530	\$ 1,722,340,803

Risk as of June 30, 1995

<u>Investment Type</u>	<u>Category 1</u>	<u>Category 2**</u>	<u>Carrying Amount</u>	<u>Market Value</u>
Corporate Asset-Backed	\$ 95,551,175	\$ 0	\$ 95,551,175	\$ 96,257,162
Corporate Other	767,502,957	57,283,236	824,786,193	861,719,552
US Govt Mortgage-Backed	111,779,191	0	111,779,191	116,279,837
US Govt Direct/Indirect	85,713,153	346,699,264	432,412,417	449,670,531
Yankee Bonds	86,923,337	10,151,490	97,074,827	105,542,968
STIP	20,243,016	0	20,243,016	20,243,016
Total Investment	\$ 1,167,712,829	\$ 414,133,990	\$ 1,581,846,819	\$ 1,649,713,066

*At June 30, 1996, these securities, with a market value of \$353,364,299, were loaned under a securities lending agreement with the state's agent.

** At June 30, 1995, these securities with a market value of \$423,660,727 were loaned under a securities lending agreement with the state's agent.

The above instruments have credit risk as measured by major credit rating services. The Board of Investment's policy requires RFBP investments, at the time of purchase, to be rated an investment grade as defined by Moody's and Standard & Poor's (S&P) rating services.

Market risk for the above securities is caused by changes in the price or principal value of the security due to changes in interest rates.

As reported in the government mortgage-backed category, the RFBP portfolio holds REMICs totaling \$21,573,461 and \$33,938,560 at amortized cost, respectively, as of June 30, 1996 and June 30, 1995. One REMIC security with a June 30, 1995 amortized cost of \$9,164,378 was sold in October 1995. These securities are based on separate or combined cash flows from principal and interest payments on underlying mortgages. The POs and IOs are more sensitive to prepayments by mortgagees resulting from interest rate changes than other REMIC securities. For example, if interest rates decline and homeowners refinance mortgages, the underlying mortgages are prepaid. When underlying mortgages are prepaid, the interest cash flows are reduced while principal cash flows are increased. If homeowners pay on mortgages longer than anticipated, the cash flow effect would be the opposite.

The IO REMIC securities purchased in August and September 1992 are being amortized towards zero according to the expected average life of the underlying mortgages. The IO securities amortized cost is \$2,800,000 as of June 30, 1996 and \$2,264,188 as of June 30, 1995. The increase in the IO's amortized cost as of June 30, 1996 is attributed to an increase in the expected average life due to slower mortgage prepayments in 1996.

Corporate asset-backed securities are based on cash flows from principal and interest payments on underlying car loans, credit card receivables, trade receivables, commercial mortgages and other assets. These securities, while sensitive to prepayments due to interest rate changes, have less credit risk than securities not backed by pledged assets. Market risk is also less because principal is paid back prior to the maturity date of the securities.

With the exception of the S & A Restaurants Corp., there are no legal risks, as of June 30, 1996, that the Board is aware of regarding any RFBP investments. As of June 30, 1996, S&A Restaurants Corp. was restructuring its debt. Due to possible bankruptcy if restructuring was not completed, the Board discontinued accruing income on this security effective February 15, 1996. On August 1, 1996, the company completed its corporate restructuring. On August 15, 1996, the Board received \$613,250 in interest due for February 15 through August 14, 1996. Given the restructuring and receipt of the August 15, 1996 payment, the Board permitted the security to accrue income. At amortized cost, the RFBP owns \$11,000,000 par of S & A Restaurants Corp., 11.15% First Mortgage Bonds, maturing August 15, 1998. These bonds are backed by U.S. government securities.

As of June 30, 1995, the El Paso Electric Company presented a legal risk to the Board. El Paso Electric Company declared bankruptcy in January 1992. Per the January 1992 bankruptcy order, the company paid its monthly interest payments. In 1995, the company began merger negotiations with another company. In June 1995, these negotiations ceased. Effective June 1995, the First Mortgage bond holders were notified the June monthly interest payment and subsequent interest payments would not be paid until further notice. On September 8, 1995, the Board received \$52,846 in interest for June 1 through August 31, 1995. At amortized cost, the RFBP owned \$2,107,000 of El Paso Electric Company, 9.95% First Mortgage Bonds, maturing May 1, 2004. The \$2,107,000 par, plus accrued interest and premium, was paid in full on February 26, 1996.

5. YEAR END PORTFOLIO

The June 30, 1996 RFBP portfolio is listed below.

RFBP PORTFOLIO AS OF JUNE 30, 1996

<u>Security Name</u>	<u>Coupon</u>	<u>Maturity</u>	<u>Par</u>	<u>Amortized Cost</u>	<u>Market Value</u>
FLEET FINANCIAL GROUP	8.13	07/01/2004	5,000,000	5,273,356	5,224,950
CIT GROUP SECURITIZATION CORP	4.70	06/15/2018	1,020,551	1,019,258	1,011,621
FIRST SECURITY GRANTOR TRUST	6.25	01/15/2001	8,383,779	8,383,781	8,394,259
FORD CR AUTO LN MASTER TR	6.88	01/15/99	13,000,000	12,956,662	13,065,000
GREEN TREE FINL CORP	7.05	01/15/2018	9,587,335	9,561,600	9,635,272
GREEN TREE FINL CORP	7.50	01/15/2018	5,000,000	4,989,256	5,075,000
GREEN TREE FINL CORP	6.90	12/15/2026	5,000,000	4,873,453	4,800,000

<u>Security Name</u>	<u>Coupon</u>	<u>Maturity</u>	<u>Par</u>	<u>Amortized Cost</u>	<u>Market Value</u>
MERRILL LYNCH MTG INVS INC	6.10	02/15/2020	7,000,000	6,990,423	6,965,000
MERRILL LYNCH MTG INVS INC	5.40	12/15/2013	8,000,000	7,863,153	7,782,480
PRIME CR CARD MASTER TR	7.45	11/15/2002	8,000,000	8,007,086	8,152,480
RESOLUTION TR CORP MTG PASS	9.00	10/25/2021	1,702,236	1,705,981	1,724,961
RESOLUTION TR CORP MTG PASS	8.63	07/25/2030	1,108,649	1,102,136	1,112,340
RESOLUTION TR CORP MTG PASS	8.00	09/25/2021	3,459,860	3,419,645	3,475,083
RESOLUTION TR CORP MTG PASS	8.15	06/25/2024	1,361,720	1,399,642	1,364,743
RESOLUTION TR CORP MTG PASS	VAR	09/25/2027	1,506,788	1,500,568	1,491,132
SEARS CREDIT ACCT MASTER TRI	5.90	11/15/98	2,291,667	2,287,835	2,293,088
WORLD OMNI AUTOMOBILE LEASE	6.05	11/25/2001	10,000,000	10,000,000	9,943,700
CORPORATE ASSET-BACKED			<u>91,422,583</u>	<u>91,333,835</u>	<u>91,511,108</u>
AT+T CORP	7.75	03/01/2007	5,000,000	4,998,487	5,206,050
AMERICAN AIRLS 1991 A PASS THR	10.18	01/02/2013	5,000,000	4,996,622	5,749,750
AMERICAN EXPRESS CO	8.63	05/15/2022	5,000,000	5,506,407	5,194,400
AMERICAN GEN CORP	9.63	02/01/2018	5,000,000	4,982,144	5,340,550
AMERICAN PRESIDENT COS LTD	7.13	11/15/2003	9,000,000	8,951,500	8,669,070
AMERICAN PRESIDENT COS LTD	8.00	01/15/2024	5,000,000	4,631,052	4,681,650
AMERICAN STORES CO NEW	9.13	04/01/2002	5,000,000	5,432,127	5,441,800
AMPROP FINANCE CO	10.39	08/01/2001	2,885,700	2,885,700	3,127,810
ARCHER DANIELS MIDLAND CO	10.25	01/15/2006	3,500,000	3,489,610	4,188,870
ARIZONA PUB SVC CO	9.50	04/15/2021	8,000,000	7,871,193	8,638,320
ARKANSAS PWR + LT CO	9.75	07/01/2019	3,500,000	3,457,045	3,768,065
ARKANSAS PWR + LT CO	7.90	11/01/2002	5,000,000	4,963,654	5,057,000
ASARCO INC	7.88	04/15/2013	5,000,000	4,688,610	4,894,150
ASHLAND OIL CO	11.13	10/15/2017	4,000,000	3,923,660	4,405,600
ASHLAND OIL CO	8.80	11/15/2012	7,500,000	7,796,567	8,254,725
ATCHISON TOPEKA + SANTA FE RY	6.55	01/06/2013	10,000,000	10,000,000	9,428,100
BANKAMERICA CORP	7.63	06/15/2004	5,000,000	4,935,236	5,121,200
BANKERS TR NY CORP	8.13	04/01/2002	5,000,000	4,991,342	5,207,750
BORDEN INC	9.25	06/15/2019	5,500,000	5,269,196	5,148,440
BURLINGTON NORTHN RR CO	7.97	01/01/2015	4,998,368	4,998,368	5,213,248
BURLINGTON NORTHN RR CO	6.94	01/02/2014	5,000,000	5,000,000	4,759,250
CNA FINL CORP	6.25	11/15/2003	5,000,000	4,811,955	4,678,750
CARTER HOLT HARVEY LTD	7.63	04/15/2002	5,000,000	5,141,666	5,101,950
CHAMPION INTL CORP	7.63	09/01/2023	10,000,000	9,763,071	9,188,300
CHASE MANHATTAN CORP NEW	8.50	02/15/2002	5,000,000	5,184,613	5,349,000
CHEVRON CAP U S A INC	9.75	07/15/2017	10,000,000	9,949,808	10,751,000
CHICAGO + NORTH WESTERN RY	8.91	01/01/2015	10,000,000	10,000,000	11,034,700
CHRYSLER FINL CORP	5.38	10/15/98	4,000,000	3,977,964	3,902,400
CLEVELAND ELEC ILLUM CO	10.00	06/01/2020	3,000,000	2,976,044	3,023,040
CLEVELAND ELEC ILLUM CO	7.63	08/01/2002	3,500,000	3,498,400	3,241,245
CLEVELAND ELEC ILLUM CO	9.00	07/01/2023	3,000,000	2,980,255	2,679,570
COLONIAL PIPELINE	7.13	08/15/2002	8,000,000	7,820,939	7,980,800
COMMONWEALTH EDISON CO	8.38	02/15/2023	3,000,000	2,982,691	2,952,900
CONAGRA INC	7.40	09/15/2004	5,000,000	5,022,768	4,997,850
CONSOLIDATED NAT GAS CO	8.75	10/01/2019	10,000,000	10,000,000	10,569,800
CONTINENTAL CORP	7.25	03/01/2003	8,000,000	7,776,423	7,958,000
CORPORATE PPTY INVS	7.75	08/15/2004	5,000,000	5,118,779	5,036,800
CORPORATE PPTY INVS	7.18	09/01/2013	5,000,000	5,088,047	4,722,200
CORPORATE PPTY INVS	7.88	03/15/2016	7,000,000	6,975,967	6,839,490
DAYTON HUDSON CORP	9.50	10/15/2016	5,000,000	4,966,139	5,235,500
DAYTON HUDSON CORP	9.25	11/15/2016	2,000,000	1,864,351	2,096,820
DAYTON HUDSON CORP	7.88	06/15/2023	3,000,000	3,117,646	2,864,580
DAYTON HUDSON CORP	7.65	08/01/2023	1,500,000	1,507,785	1,386,930

<u>Security Name</u>	<u>Coupon</u>	<u>Maturity</u>	<u>Par</u>	<u>Amortized Cost</u>	<u>Market Value</u>
DEER PARK REFINING L P	6.47	12/15/2008	10,000,000	9,754,955	9,519,600
DELTA AIR LINES INC	10.14	08/14/2012	2,000,000	2,000,000	2,281,060
DELTA AIR LINES INC	10.14	08/14/2012	4,000,000	3,975,562	4,562,120
DELTA AIR LINES INC DEL	10.00	06/05/2011	1,971,000	1,942,911	2,271,578
DELTA AIR LINES INC	10.00	06/05/2013	3,000,000	3,000,000	3,397,470
DIAMOND SHAMROCK INC	8.00	04/01/2023	7,000,000	6,887,142	6,769,980
DILLARD DEPT STORES INC	9.50	10/15/2001	5,000,000	5,052,188	5,482,750
DU PONT E I DE NEMOURS + CO	8.25	01/15/2022	7,000,000	7,704,251	7,172,690
DU PONT E I DE NEMOURS + CO	7.95	01/15/2023	6,000,000	5,919,238	5,995,800
ENRON CORP	6.75	09/15/2004	7,000,000	6,681,791	6,773,200
ENSERCH CORP	7.13	06/15/2005	5,000,000	5,119,912	4,879,700
EQUITABLE COS INC	6.75	12/01/2000	5,000,000	4,996,912	5,010,500
FMC CORP	6.38	09/01/2003	6,000,000	5,976,468	5,609,040
FIRST BK SYS INC	6.63	05/15/2003	3,500,000	3,283,876	3,369,240
FIRST PV FDG CORP	10.15	01/15/2016	6,000,000	5,622,316	6,315,000
FIRST PREFFERD SHIP MTG	7.50	01/01/99	89,971	89,971	89,971
FIRST PFD SHIP MTGE	7.50	01/01/99	89,971	89,971	89,971
FIRST PFD SHIP MTGE	7.50	01/01/99	89,971	89,971	89,971
FIRST UN CORP	7.05	08/01/2005	5,000,000	5,081,280	4,886,000
FLORIDA GAS TRANSMISSION CO	9.19	11/01/2024	10,000,000	9,924,537	11,375,800
FORD MTR CR CO	7.50	01/15/2003	5,000,000	5,071,107	5,068,750
FORD MTR CR CO	6.75	05/15/2005	2,000,000	2,055,521	1,916,580
GTE CORP	10.75	09/15/2017	4,000,000	3,946,942	4,365,240
GTE CORP	10.30	11/15/2017	6,000,000	6,000,000	6,573,000
GTE CORP	7.83	05/01/2023	10,000,000	9,889,152	9,826,900
GTE SOUTH INC	7.50	03/15/2026	6,000,000	5,933,121	5,801,400
GENERAL AMERN TRANSN CORP 94 1	8.42	01/01/2015	10,000,000	10,000,000	10,643,000
GENERAL ELEC CAP CORP	6.20	03/15/97	1,350,000	1,347,532	1,353,132
GENERAL MTRS ACCEP CORP	8.40	10/15/99	5,000,000	4,966,066	5,248,050
GENERAL MTRS CORP	9.63	12/01/2000	5,000,000	5,369,918	5,508,300
GEORGIA PAC CORP	9.75	01/15/2018	4,000,000	3,935,300	4,188,680
GEORGIA PAC CORP	9.13	07/01/2022	3,000,000	2,927,506	3,111,990
GEORGIA PAC CORP	8.25	03/01/2023	15,000,000	15,151,169	14,518,350
GULF STS UTILS CO	8.70	04/01/2024	5,000,000	5,000,000	5,128,000
HFS INC	5.88	12/15/98	4,500,000	4,492,900	4,389,075
INTERNATIONAL MINERALS + CHEM	9.88	03/15/2011	4,000,000	4,129,040	4,470,240
KERR MCGEE CORP	8.50	06/01/2006	1,535,000	1,388,549	1,560,926
KERR MCGEE CORP	7.00	11/01/2011	2,000,000	1,824,899	1,880,100
KEYCORP NEW	7.50	06/15/2006	5,000,000	4,990,256	5,035,800
LONG ISLAND LTG CO	9.75	05/01/2021	6,500,000	6,434,775	6,677,710
LOUISIANA PWR + LT CO	8.50	07/01/2022	3,500,000	3,482,900	3,424,855
LUCKY STORES	16.00	12/10/2001	210,032	210,032	210,032
LUCKY STORES	16.00	10/29/2001	283,597	283,597	283,597
MCI COMMUNICATIONS CORP	7.75	03/23/2025	3,000,000	2,970,120	2,945,820
MAY DEPT STORES CO	9.13	12/01/2016	2,000,000	1,895,669	2,058,960
MERIDIAN TRAILER TRAIN	9.85	01/29/2010	2,048,086	2,048,086	2,289,555
MERIDIAN TRAILER TRAIN	9.85	01/29/2008	2,433,127	2,433,127	2,698,509
METROPOLITAN LIFE INS CO	7.45	11/01/2023	10,000,000	9,777,623	9,068,100
MISSISSIPPI PWR + LT CO	7.70	07/15/2023	11,000,000	10,875,074	10,230,440
MONTANA PWR CO	7.00	03/01/2005	3,000,000	2,986,999	2,902,350
MONTANA PWR CO	7.20	06/01/2000	10,000,000	10,000,000	10,095,600
NGC CORP	6.75	12/15/2005	5,000,000	5,080,281	4,765,950
NATIONSBANK CORP	7.75	08/15/2004	5,000,000	4,703,510	5,139,850
NEW YORK LIFE INS COR	7.50	12/15/2023	5,000,000	4,730,804	4,666,300
NEW YORK ST ELEC + GAS CORP	9.88	11/01/2020	6,200,000	6,139,492	7,169,122

<u>Security Name</u>	<u>Coupon</u>	<u>Maturity</u>	<u>Par</u>	<u>Amortized Cost</u>	<u>Market Value</u>
NORTH ELECTRIC PP	8.63	09/01/96	25,000	25,000	25,000
NORTHWEST PIPELINE CORP	9.00	08/01/2022	6,000,000	6,067,215	6,330,540
OCCIDENTAL PETE CORP MTN	8.75	01/15/2023	5,000,000	4,865,366	5,495,100
OXY USA INC	7.00	04/15/2011	3,000,000	2,790,405	2,744,580
PACIFIC BELL	7.38	06/15/2025	10,000,000	9,483,145	9,463,800
PACIFIC GAS + ELEC CO	5.38	08/01/98	5,000,000	4,856,602	4,870,100
PAINE WEBBER GROUP INC	7.00	03/01/2000	5,000,000	4,992,788	4,982,850
PANHANDLE EASTN PIPE LINE CO	7.95	03/15/2023	2,800,000	2,656,256	2,693,124
PENNEY J C INC	9.75	06/15/2021	5,000,000	5,210,430	5,601,050
PENNZOIL CO	9.63	11/15/99	2,000,000	1,997,639	2,143,480
PENNZOIL CO	9.00	04/01/2017	765,000	755,396	796,220
PHILADELPHIA ELEC CO	6.50	05/01/2003	4,000,000	3,985,460	3,843,280
PHILADELPHIA ELEC CO	7.75	05/01/2023	5,000,000	4,925,104	4,816,200
PHILADELPHIA ELEC CO	7.25	11/01/2024	2,000,000	1,944,882	1,862,540
PHILLIPS PETE CO	9.38	02/15/2011	5,000,000	4,991,145	5,755,900
PHILLIPS PETE CO	8.49	01/01/2023	12,000,000	11,962,142	12,170,400
PHILLIPS PETE CO	7.20	11/01/2023	7,000,000	6,355,299	6,426,210
PLANTATION PIPE LINE CO	7.00	02/01/99	44,500	44,500	44,500
QUAKER ST CORP	6.63	10/15/2005	5,000,000	5,035,151	4,723,800
QUESTAR PIPELINE CO	9.88	06/01/2020	2,500,000	2,489,426	2,728,475
RELIASTER FINL CORP	6.63	09/15/2003	7,500,000	7,490,791	7,052,475
REVLON CONSUMER PRODS CORP	10.88	07/15/2010	4,500,000	4,348,810	4,500,000
ROHR INDS INC	9.25	03/01/2017	3,000,000	3,000,000	2,715,000
S + A RESTAURANT CORP	11.15	08/15/98	11,000,000	11,000,000	11,149,160
ST LOUIS SOUTHWESTN RY CO	10.10	05/15/2005	1,371,291	1,371,291	1,506,088
SEA LAND SVC INC	10.60	01/02/2011	315,000	315,000	335,151
SEA LAND SVC INC	10.60	01/02/2011	6,815,000	6,815,000	7,250,956
SERVICE CORP INTL	6.88	10/01/2007	5,000,000	5,047,734	4,743,600
SHOPKO STORES INC	8.50	03/15/2002	5,000,000	5,291,046	5,110,350
SOUTHERN UN CO NEW	7.60	02/01/2024	10,000,000	9,830,614	9,443,300
SOUTHWEST GAS CORP	9.38	02/01/2017	14,100,000	13,844,118	14,802,603
SOUTHWESTERN BELL TEL CO	7.25	07/15/2025	7,000,000	7,211,518	6,577,900
SUNAMERICA INC	8.13	04/28/2023	10,400,000	10,341,877	10,385,752
SUPER VALUE STORE	8.88	11/15/2022	3,000,000	2,997,784	3,119,610
TELE COMMUNICATIONS INC	8.75	02/15/2023	6,500,000	6,528,297	6,132,880
TELE COMMUNICATIONS INC	7.88	08/01/2013	10,000,000	9,636,328	9,110,800
TEXAS EASTN TRANSMISSION CORP	10.13	09/01/2011	3,000,000	2,994,319	3,171,600
TEXAS EASTN TRANSMISSION CORP	10.00	10/01/2011	7,300,000	7,283,705	7,712,961
TEXAS NEW MEX PWR CO	10.00	07/01/2017	5,818,000	5,798,270	5,814,276
TEXAS UTILS ELEC CO	8.88	02/01/2022	5,000,000	5,077,305	5,012,000
TEXAS UTILS ELEC CO	6.38	08/01/97	3,000,000	2,997,383	3,000,810
TEXAS UTILS ELEC CO	8.75	11/01/2023	5,000,000	4,967,407	5,127,700
TEXAS UTILS ELEC CO	7.88	03/01/2023	3,500,000	3,441,789	3,404,240
TEXTRON INC	8.75	07/01/2022	3,500,000	3,638,271	3,657,395
TOLEDO EDISON CO	7.25	08/01/99	5,700,000	5,697,226	5,419,161
TRANSCONTINENTAL GAS PIPE LINE	9.13	02/01/2017	9,500,000	9,174,423	9,885,035
TRI CITY PPTY INVS CORP	13.50	03/01/99	1,231,667	1,231,667	1,334,524
TYCO LABS INC	6.38	01/15/2004	5,000,000	4,970,736	4,689,250
USG CORP	8.75	03/01/2017	8,000,000	7,651,863	7,840,000
UNION OIL CO CA MTN BK ENT	6.70	10/15/2007	5,000,000	4,981,760	4,643,500
UNION PAC CORP	8.50	01/15/2017	5,000,000	4,488,853	5,103,900
UNION PAC CORP	6.40	02/01/2006	3,000,000	2,953,886	2,793,000
UNION PAC RR CO	7.75	07/01/2012	9,868,087	9,868,087	10,209,720
U S BANCORP OR	6.75	10/15/2005	5,000,000	4,975,008	4,768,350
U S WEST COMMUNICATIONS INC	7.50	06/15/2023	5,000,000	4,557,486	4,764,050

<u>Security Name</u>	<u>Coupon</u>	<u>Maturity</u>	<u>Par</u>	<u>Amortized Cost</u>	<u>Market Value</u>
WAL MART STORES INC PASS THRU	7.49	06/21/2007	7,000,000	6,881,521	7,009,940
WASHINGTON GAS LT CO	8.63	03/01/2017	4,000,000	3,805,284	4,218,560
WESTERN INVT REAL ESTATE TR	7.88	02/15/2004	7,000,000	6,984,481	7,020,790
WESTINGHOUSE ELEC CORP	8.63	08/01/2012	8,000,000	8,383,322	7,721,360
WESTINGHOUSE ELEC CORP	6.88	09/01/2003	1,500,000	1,500,000	1,374,900
WESTVACO CORP	7.00	08/15/2023	5,000,000	4,377,477	4,471,050
WEYERHAEUSER CO	8.50	01/15/2025	5,000,000	4,969,219	5,454,650
WILMINGTON TR TUSCON ELECTRIC	10.21	01/01/2009	11,000,000	11,000,000	11,000,000
CORPORATE OTHER			<u>841,738,367</u>	<u>835,112,455</u>	<u>848,318,621</u>
FED HM LN PC G10173	6.00	01/01/2009	11,485,692	11,437,603	10,961,600
FED HM LN PC G30006	7.00	07/01/2013	10,138,105	10,251,301	10,109,515
FEDERAL HOME LN MTG REMIC-IO	VAR	08/15/2007	28,730,570	1,000,000	2,307,424
FEDERAL HOME LN MTG REMIC-IO	VAR	09/15/2007	20,759,346	800,000	1,006,828
FEDERAL HOME LN MTG PC REMIC	7.00	10/15/97	1,206,580	1,211,625	1,210,345
FED HM LN PC E00247	5.50	10/01/2008	12,579,079	12,496,475	11,722,067
FEDERAL HOME LN MTG PC REMIC	9.30	11/15/2020	2,350,000	2,260,227	2,470,438
FEDERAL NATL MTG ASSN REMIC-IO	VAR	08/25/2007	27,742,743	1,000,000	1,900,378
FEDERAL NATL MTG ASSN REMIC-PO	NA	05/25/2023	5,556,750	4,710,727	4,653,778
FEDERAL NATL MTG ASSN REMIC-PO	NA	10/25/2020	6,739,113	5,684,875	5,728,246
FEDERAL NATL MTG ASSN REMIC	9.50	03/25/2020	5,000,000	4,906,007	5,507,800
FNMA POOL 109031	6.70	08/01/2005	7,000,000	6,814,910	6,761,580
FNMA POOL 303365	6.50	05/01/2009	22,017,992	21,506,536	21,460,497
FNMA POOL 303125	7.50	01/01/2010	12,112,572	12,040,542	12,256,348
FNMA POOL 303202	6.50	05/01/2014	9,052,663	8,920,938	8,614,152
FNMA POOL 303590	7.00	10/01/2010	9,349,616	9,416,299	9,223,957
GNMA POOL 001254	9.50	09/20/2019	536,771	533,404	570,985
GNMA POOL 046249	10.00	12/15/2010	240,507	238,931	262,249
GNMA POOL 135544	10.00	01/15/2016	164,194	162,987	179,272
GNMA POOL 237102	9.50	11/15/2017	366,795	364,072	394,873
US GOVERNMENT MORTGAGE-BACKED			<u>193,129,088</u>	<u>115,757,459</u>	<u>117,302,329</u>
FEDERAL HOME LN MTG CORP	8.20	09/15/2005	112,125	112,001	118,446
FEDERAL NATL MTG ASSN PRN STRP	0.00	12/20/2021	10,000,000	8,823,985	8,803,100
FEDERAL NATL MTG ASSN PRN STRP	0.00	03/09/2022	8,000,000	7,316,471	6,911,280
FEDERAL NATL MTG ASSN PRN STRP	0.00	11/01/2022	20,000,000	17,125,421	16,181,200
FEDERAL NATL MTG ASSN MTN	7.13	04/30/2026	15,000,000	14,567,636	14,759,550
LIBERTY CRUISE LINE INC	9.85	12/15/2003	2,083,000	2,081,536	2,377,515
STUDENT LN MARKETING ASSN	0.00	05/15/2014	150,000,000	29,674,726	33,750,000
THIRD ATTRANSCO TANKER CORP	8.80	05/01/2008	1,850,000	1,792,195	2,021,458
USGG SHIPPING + CENAC TOWING	7.00	05/15/2021	16,283,000	16,283,000	15,657,081
UNITED STATES TREAS BDS	8.75	11/15/2008	31,000,000	35,330,735	34,385,820
UNITED STATES TREAS BDS	9.13	05/15/2009	30,500,000	32,739,526	34,698,630
UNITED STATES TREAS BDS	9.25	02/15/2016	32,000,000	37,769,015	39,575,040
UNITED STATES TREAS BDS	7.25	05/15/2016	36,000,000	37,550,479	36,843,840
UNITED STATES TREAS BDS	7.50	11/15/2016	34,000,000	37,057,509	35,721,080
UNITED STATES TREAS NTS	8.25	07/15/98	15,100,000	15,696,086	15,696,903
UNITED STATES TREAS NTS	7.88	08/15/2001	16,900,000	17,484,554	17,903,353
UNITED STATES TREAS NTS	7.50	11/15/2001	15,000,000	16,595,457	15,658,650
UNITED STATES TREAS NTS	6.38	08/15/2002	26,000,000	26,772,723	25,792,780
UNITED STATES TREAS NTS	6.25	02/15/2003	32,000,000	33,029,348	31,434,880
UNITED STATES TREAS NTS	7.25	05/15/2004	15,000,000	15,642,242	15,541,350
UNITED STATES TREAS NTS	7.25	08/15/2004	10,000,000	10,983,974	10,357,800
UNITED STATES TREAS NTS	7.50	10/31/99	10,000,000	10,404,750	10,326,600
UNITED STATES TREAS NTS	8.88	02/15/99	16,500,000	17,228,933	17,528,610

<u>Security Name</u>	<u>Coupon</u>	<u>Maturity</u>	<u>Par</u>	<u>Amortized Cost</u>	<u>Market Value</u>
UNITED STATES TREAS NTS	9.13	05/15/99	10,000,000	10,529,379	10,726,600
UNITED STATES TREAS NTS	8.75	10/15/97	16,000,000	16,514,737	16,549,920
WHITNEY STEAMSHIP CO	9.30	04/29/2000	179,382	179,382	179,382
U S T BOND CORPUS	0.00	05/15/2011	13,000,000	5,853,999	6,518,590
US TREAS BD CORPUS	0.00	11/15/2011	19,000,000	8,216,904	9,162,750
US GOVERNMENT DIRECT/INDIRECT			<u>601,507,506</u>	<u>483,356,707</u>	<u>485,182,209</u>
ALCAN ALUM LTD	9.63	07/15/2019	5,700,000	5,427,268	6,240,303
AMOCO CDA PETE CO	7.95	10/01/2022	6,000,000	6,247,379	6,094,740
BRITISH COLUMBIA HYDRO + PWR	12.50	09/01/2013	8,600,000	8,692,052	9,905,996
CANADIAN NATL RY CO	7.00	03/15/2004	5,000,000	4,970,655	4,821,100
CANADIAN PAC LTD	9.45	08/01/2021	5,000,000	5,206,472	5,747,950
CANADIAN PAC LTD	6.88	04/15/2003	5,000,000	5,018,150	4,866,000
CANADIAN REYNOLDS METALS LTD	6.63	07/15/2002	10,000,000	9,965,352	9,710,700
FORD CAPITAL BV	9.88	05/15/2002	2,000,000	1,984,564	2,261,060
GREAT LAKES PWR INC	9.00	08/01/2004	5,000,000	4,981,074	5,289,900
GRAND METROPOLITAN	7.00	06/15/99	5,000,000	4,937,801	5,037,500
HYDRO QUEBEC	13.25	12/15/2013	3,100,000	3,100,000	3,649,630
INCO LTD	9.88	06/15/2019	10,000,000	10,076,797	10,821,500
MACMILLAN BLOEDEL LTD	7.70	02/15/2026	10,000,000	9,772,218	9,062,200
NEWS AMER HLDGS INC	8.88	04/26/2023	5,000,000	5,719,830	5,187,200
NORSK HYDRO A S	9.00	04/15/2012	2,500,000	2,645,524	2,810,750
PANAMERICAN BEVERAGES INC	8.13	04/01/2003	5,000,000	4,958,335	4,971,750
PHILIPS ELEC NV	6.75	08/15/2003	5,000,000	4,897,333	4,817,350
PHILIPS ELECTRS NV	7.75	04/15/2004	5,000,000	4,883,660	5,101,250
TRANSCANADA PIPELINES LTD	8.50	03/20/2023	5,000,000	5,257,204	5,288,250
YANKEE BONDS			<u>107,899,999</u>	<u>108,741,667</u>	<u>111,685,129</u>
TOTAL FIXED INCOME			<u>1,835,697,543</u>	<u>1,634,302,123</u>	<u>1,653,999,396</u>
SHORT TERM INVESTMENT POOL			<u>68,341,407</u>	<u>68,341,407</u>	<u>68,341,407</u>
TOTAL RFBP			<u>\$1,904,038,950</u>	<u>\$1,702,643,530</u>	<u>1,722,340,803</u>

Independent Auditor's Report & Trust Funds Bond Pool Financial Statements

MONTANA LEGISLATIVE BRANCH

Legislative Auditor
Scott A. Seacat

Legal Counsel:
John Northey



Deputy Legislative Auditors:
Mary Bryson
Operations and EDP Audit
James Gillett
Financial-Compliance Audit
Jim Pellegrini
Performance Audit

LEGISLATIVE AUDIT DIVISION

INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the accompanying Statement of Net Asset Value for the state of Montana Board of Investments, Trust Funds Bond Pool, as of June 30, 1996, and the related Statement of Changes in Net Asset Value and Statement of Investment Income and Distribution for the fiscal year then ended. These financial statements are the responsibility of the Board of Investments' management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net asset value of the state of Montana Board of Investments, Trust Funds Bond Pool, as of June 30, 1996, and its changes in net asset value and investment income and distributions for the fiscal year then ended in conformity with generally accepted accounting principles.

Respectfully submitted,

A handwritten signature in cursive script that reads "James Gillett".

James Gillett, CPA
Deputy Legislative Auditor

October 4, 1996

**STATE OF MONTANA BOARD OF INVESTMENTS
TRUST FUNDS BOND POOL FINANCIAL STATEMENTS**

STATEMENT OF NET ASSET VALUE, JUNE 30, 1996

	<u>1996</u>
<u>Assets</u>	
Cash	\$ 0
Interest receivable	17,389,871
Investments managed at current value (amortized cost of \$838,465,319 in 1996 (Notes 2 and 4))	<u>850,970,143</u>
Total assets	\$ <u>868,360,014</u>
<u>Liabilities</u>	
Income due participants (Note 2)	<u>5,555,844</u>
Total liabilities	<u>5,555,844</u>
Net asset value	\$ <u>862,804,170</u>
Units Outstanding	8,881,193
Unit Value	\$ 97.15

**STATEMENT OF CHANGES IN NET ASSET VALUE
FOR THE FISCAL YEAR ENDED JUNE 30, 1996**

Net asset value, beginning of year	\$ 0
Value of units purchased by participants	850,299,345
Value of units sold by participants	0
Changes in current value of investments managed	<u>12,504,825</u>
Net asset value, end of year	\$ <u>862,804,170</u>

**STATEMENT OF INVESTMENT INCOME AND DISTRIBUTION
FOR THE FISCAL YEAR ENDED JUNE 30, 1996**

Investment income	\$ 54,365,145
Administrative expenses	(126,684)
Income due participants, beginning of year	<u>0</u>
Income available for distribution	<u>54,238,461</u>
Distribution	<u>48,682,617</u>
Income due participants, end of year	\$ <u>5,555,844</u>

The accompanying notes are an integral part of these financial statements.

**STATE OF MONTANA BOARD OF INVESTMENTS
TRUST FUNDS BOND POOL**

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 1996**

1. HISTORY AND ORGANIZATION

The Board was created by an act of the Legislature to invest and manage the State of Montana's investment funds on a centralized basis. The Trust Funds Bond Pool (TFBP) was created by the Board to allow qualifying funds, per Section 17-6-201, MCA, to participate in a diversified pool. The TFBP was created as of October 1, 1995 by the transfer of all fixed income and variable-rate securities owned by the Coal Severance Tax Permanent Trust, Resource Indemnity Trust, Coal Tax Park Trust, Trust and Legacy, Coal Tax Cultural Trust and Treasure State Endowment Trust funds. These securities were previously recorded in the All Other Funds financial statements for the fiscal year ended June 30, 1995. The University of Montana endowment fund became a pool participant on January 1, 1996; and on March 1, 1996, the Department of Natural Resources' Coal Severance Tax School Bond Contingency fund joined the pool.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Investments

TFBP investments are purchased in accordance with the statutorily mandated "Prudent Expert Principle". The TFBP portfolio includes corporate asset-backed, other corporate, U.S. government mortgage-backed, government and yankee securities. Corporate asset-backed securities represent debt securities collateralized by a pool of assets. U.S. government mortgage-backed securities reflect participation in a pool of residential mortgages. Government securities include direct and indirect obligations of the U.S. Treasury and state and local government bonds. Yankee bonds are U.S. dollar denominated bonds issued by foreign corporations and governments and U.S. companies issuing debt in foreign markets.

The TFBP portfolio includes structured financial instruments known as REMICs (Real Estate Mortgage Investment Conduits). REMICs are pass-through vehicles for multiclass mortgage-backed securities. Some TFBP REMICs are principal-only strips (POs). POs receive cash flow from the principal payment component on underlying mortgage loans. Strip investments represent the separate purchase of the principal and interest cash flows of a mortgage security. These securities, purchased for portfolio diversification and a competitive rate of return, are identified and reported as government mortgage-backed securities in the investment risk and portfolio disclosures. (See Note 4 on Investment Risk Categories and Note 5 for the Year End Portfolio.)

TFBP fixed income securities pay a fixed rate of interest until maturity while the variable-rate (floating-rate) securities pay a variable interest rate until maturity. The variable-rate security floats with the weighted average of the net mortgage interest rates for the mortgage loan group. The one variable-rate security, with an amortized cost of \$1,506,577 on June 30, 1996, is identified and reported as a corporate asset-backed security in the investment risk

and portfolio disclosures. (See Note 4 on Investment Risk Categories and Note 5 for the Year End Portfolio.)

Investments are presented in the Statement of Net Asset Value at current value. Current values for securities are determined primarily by reference to market prices supplied to the Board by the Board's custodial bank, State Street Bank. Amortized cost, parenthetically disclosed, represents the original cost, adjusted for premium and discount amortization where applicable. Premiums and discounts are amortized/accreted using the straight-line or interest method to the call, average life or maturity date of the securities.

Participant Units

The Coal Severance Tax Permanent Trust, Resource Indemnity Trust, Coal Tax Park Trust, Trust and Legacy, Coal Tax Cultural Trust, and Treasure State Endowment Trust funds transferred all fixed income and variable-rate securities, at amortized cost, into the TFBP at the start-up date and were issued units according to the market value of each participant's portfolio. The initial unit value as of October 1, 1995 was \$100.00. Unit values are calculated weekly, based on portfolio pricing, to allow for participant transactions to occur as determined by the investment officer.

Other

Accumulated income, recorded as Income Due Participants, is distributed monthly on the first calendar day of each month. Realized portfolio gains/losses are distributed at least annually to the participants.

Investment income reported in the Statement of Investment Income and Distribution includes interest accruals, security lending income, realized gains/losses, amortization/accretion and miscellaneous income. The TFBP reflects income earned by the pool for nine months from October 1, 1995 to June 30, 1996.

3. SECURITIES LENDING

The Board has an agreement with the custodial bank, State Street Bank, whereby State Street Bank lends to other entities securities managed by the Board. During the period the securities are on loan, the Board receives a fee and State Street Bank must maintain collateral equal to 102 percent of the market value of the securities on loan. The Board retains all rights and risks of ownership during the loan period. Securities lending income was \$243,201 for fiscal year 1996. On June 30, 1996, \$174,551,753 in securities were on loan to other entities.

4. INVESTMENT RISK CATEGORIES

State of Montana investments are categorized below to give an indication of the level of risk assumed at June 30, 1996. Category 1 includes investments that are insured or registered, or securities that are held by the Board or its agent in the Board's name. Category 2 includes uninsured and unregistered investments, with securities held by the counterpart trust department or agent in the Board's name.

Risk as of June 30, 1996

<u>Investment Type</u>	<u>Category 1</u>	<u>Category 2 *</u>	<u>Carrying Amount</u>	<u>Market Value</u>
Corporate Asset-Backed	\$ 25,905,011	\$ 0	\$ 25,905,011	\$ 25,799,179
Corporate Other	449,126,172	8,820,854	457,947,026	467,026,444
US Govt Mortgage-Backed	50,403,646	0	50,403,646	49,758,690
US Govt Direct/Indirect	42,215,176	163,661,291	205,876,467	207,458,147
Yankee Bonds	53,088,177	2,069,608	55,157,785	57,798,169
State and Local Government	8,947,249	0	8,947,249	8,901,379
STIP	<u>34,228,135</u>	<u>0</u>	<u>34,228,135</u>	<u>34,228,135</u>
Total Investment	\$ <u>663,913,566</u>	\$ <u>174,551,753</u>	\$ <u>838,465,319</u>	\$ <u>850,970,143</u>

* At June 30, 1996, these securities with a market value of \$173,582,343 were loaned under a securities lending agreement with the state's agent.

The above instruments have credit risk as measured by major credit rating services. The Board of Investment's policy requires TFBP investments, at the time of purchase, to be rated an investment grade as defined by Moody's and Standard & Poor's (S&P) rating services.

Market risk for the above securities is caused by changes in the price or principal value of the security due to changes in interest rates.

As reported in the U.S. government mortgage-backed category, the TFBP portfolio holds REMICs totaling \$16,393,172 at amortized cost as of June 30, 1996. As of June 30, 1995, these securities were reported with an amortized cost of \$23,228,330 in the All Other Funds financial statements. One REMIC, with a June 30, 1995 amortized cost of \$2,597,064, was sold in October 1995. These securities are based on separate or combined cash flows from principal and interest payments on underlying mortgages. The POs are more sensitive to prepayments by mortgagees resulting from interest rate changes than most other REMIC securities. For example, if interest rates decline and homeowners refinance mortgages, the underlying mortgages are prepaid. When underlying mortgages are prepaid, the interest cash flows are reduced while principal cash flows are increased. If homeowners pay on mortgages longer than anticipated, the cash flow effect would be the opposite.

Corporate asset-backed securities are based on cash flows from principal and interest payments on underlying car loans, credit card receivables, trade receivables, commercial mortgages and other assets. These securities, while sensitive to prepayments due to interest rate changes, have less credit risk than securities not backed by pledged assets. Market risk is also less because principal is paid back prior to the maturity date of the securities.

With the exception of the S & A Restaurants Corp., there are no legal risks, as of June 30, 1996, that the Board is aware of regarding any TFBP investments. As of June 30, 1996, S&A Restaurants Corp. was restructuring its debt. Due to possible bankruptcy if the restructuring was not completed, the Board discontinued accruing income on this security effective February 15, 1996. On August 1, 1996, the company completed its corporate debt restructuring. On August 15, 1996, the Board received \$223,000 in interest due for February 15 through August 14, 1996. Given the restructuring and receipt of the August 15, 1996 payment, the Board permitted the security to accrue income. At amortized cost, the TFBP

owns \$4,000,000 par of S & A Restaurants Corp., 11.15% First Mortgage Bonds, maturing August 15, 1998. These bonds are backed by U.S. government securities.

As of June 30, 1995, the El Paso Electric Company, presented a legal risk to the Board. This security, reported in the June 30, 1995 All Other Funds financial statements, was transferred to the TFBP on October 1, 1995. El Paso Electric Company declared bankruptcy in January 1992. Per the January 1992 bankruptcy order, the company paid its monthly interest payments. In 1995, the company began merger negotiations with another company. In June 1995, these negotiations ceased. Effective June 1995, the First Mortgage bond holders were notified the June monthly interest payment and subsequent interest payments would not be paid until further notice. On September 8, 1995, the Board received \$35,164 in interest for June 1 through August 31, 1995. At amortized cost, the TFBP owned \$1,402,000 of El Paso Electric Company, 9.95% First Mortgage Bonds, maturing May 1, 2004. The \$1,402,000 par, plus accrued interest and premium, was paid in full on February 26, 1996.

5. YEAR END PORTFOLIO

The June 30, 1996 TFBP portfolio is listed below.

TFBP PORTFOLIO AS OF JUNE 30, 1996

<u>Security Name</u>	<u>Coupon</u>	<u>Maturity</u>	<u>Par</u>	<u>Book Value</u>	<u>Market Value</u>
CIT GROUP SECURITIZATION CORP	4.70	06/15/2018	437,379	436,825	433,552
E Q ASSET TR	5.00	10/15/2008	78,676	78,544	78,360
FORD CR AUTO LN MASTER TR	6.88	01/15/99	6,000,000	5,977,903	6,030,000
GREEN TREE FINL CORP	7.05	01/15/2018	3,486,304	3,476,946	3,503,735
GREEN TREE FINL CORP	6.90	12/15/2026	10,000,000	9,746,905	9,600,000
MERRILL LYNCH MTG INVS INC	5.40	12/15/2013	2,000,000	1,965,788	1,945,620
RESOLUTION TR CORP MTG PASS	8.63	07/25/2030	554,328	551,072	556,174
RESOLUTION TR CORP MTG PASS	8.15	06/25/2024	907,815	916,401	909,830
RESOLUTION TR CORP MTG PASS	VAR	09/25/2027	1,506,788	1,506,577	1,491,132
SEARS CREDIT ACCT MASTER TRI	5.90	11/15/98	1,250,000	1,248,051	1,250,775
CORPORATE ASSET-BACKED			<u>26,221,289</u>	<u>25,905,011</u>	<u>25,799,179</u>
AMERICAN AIRLS 1991 C PASS	9.73	09/29/2014	5,000,000	4,963,723	5,629,400
AMERICAN PRESIDENT COS LTD	7.13	11/15/2003	6,000,000	5,967,666	5,779,380
AMPROP FINANCE CO	10.39	08/01/2001	1,236,300	1,236,300	1,340,026
ARCHER DANIELS MIDLAND CO	10.25	01/15/2006	5,000,000	4,983,526	5,984,100
ARIZONA PUB SVC CO	9.50	04/15/2021	2,000,000	1,967,798	2,159,580
ARKANSAS PWR + LT CO	9.75	07/01/2019	1,500,000	1,481,590	1,614,885
ARKANSAS PWR + LT CO	10.00	02/01/2020	3,055,000	3,022,527	3,277,496
ASHLAND OIL CO	11.13	10/15/2017	1,000,000	980,915	1,101,400
ASHLAND OIL CO	8.80	11/15/2012	2,500,000	2,574,142	2,751,575
BANKAMERICA CORP	7.88	12/01/2002	5,000,000	4,922,089	5,193,350
BANKERS TR NY CORP	8.13	04/01/2002	5,000,000	4,991,342	5,207,750
BELLSOUTH TELEC	7.88	08/01/2032	5,000,000	4,827,677	4,962,700
BORDEN INC	9.25	06/15/2019	1,500,000	1,436,445	1,404,120
BURLINGTON NORTHN INC	7.50	07/15/2023	5,000,000	4,498,488	4,700,750
BURLINGTON NORTHN RR CO	15.50	01/02/99	393,186	393,186	460,208
BURLINGTON NORTHN RR CO	7.97	01/01/2015	4,998,368	4,998,368	5,213,248
CHAMPION INTL CORP	7.63	09/01/2023	5,000,000	4,798,073	4,594,150
CHESAPEAKE + POTOMAC TEL CO DC	7.75	02/01/2023	3,000,000	2,957,219	2,954,850

<u>Security Name</u>	<u>Coupon</u>	<u>Maturity</u>	<u>Par</u>	<u>Book Value</u>	<u>Market Value</u>
CHEVRON CAP U S A INC	9.75	07/15/2017	3,000,000	2,966,539	3,225,300
CHICAGO + NORTH WESTERN RY	8.91	01/01/2015	5,000,000	5,000,000	5,517,350
CHRYSLER FINL CORP	5.38	10/15/98	4,000,000	3,977,964	3,902,400
CLEVELAND ELEC ILLUM CO	10.00	06/01/2020	2,000,000	1,984,029	2,015,360
CLEVELAND ELEC ILLUM CO	7.63	08/01/2002	1,500,000	1,485,814	1,389,105
CLEVELAND ELEC ILLUM CO	9.00	07/01/2023	2,000,000	1,986,837	1,786,380
COLONIAL PIPELINE	7.13	08/15/2002	2,000,000	1,955,235	1,995,200
COMMONWEALTH EDISON CO	9.50	05/01/2016	2,000,000	2,014,617	2,099,280
COMMONWEALTH EDISON CO	8.38	02/15/2023	2,000,000	1,988,461	1,968,600
CONAGRA INC	9.88	11/15/2005	5,000,000	5,644,736	5,760,850
CONTINENTAL CORP	7.25	03/01/2003	2,000,000	1,944,106	1,989,500
CORPORATE PPTY INVS	7.75	08/15/2004	5,000,000	5,118,779	5,036,800
CORPORATE PPTY INVS	7.88	03/15/2016	3,000,000	2,989,700	2,931,210
DAYTON HUDSON CORP	9.25	11/15/2016	3,000,000	2,796,526	3,145,230
DAYTON HUDSON CORP	7.88	06/15/2023	2,000,000	2,076,537	1,909,720
DAYTON HUDSON CORP	7.65	08/01/2023	3,500,000	3,517,795	3,236,170
DEER PARK REFINING L P	6.47	12/15/2008	5,000,000	4,836,637	4,759,800
DELTA AIR LINES INC	10.14	08/14/2012	1,000,000	1,000,000	1,140,530
DELTA AIR LINES INC	10.14	08/14/2012	2,000,000	1,987,781	2,281,060
DELTA AIR LINES INC	10.00	06/05/2013	2,000,000	2,000,000	2,264,980
DIAMOND SHAMROCK INC	8.00	04/01/2023	5,020,000	4,989,893	4,855,043
DU PONT E I DE NEMOURS + CO	8.25	01/15/2022	3,000,000	3,301,822	3,074,010
DU PONT E I DE NEMOURS + CO	7.95	01/15/2023	4,000,000	3,932,228	3,997,200
ENRON CORP	6.75	09/15/2004	3,000,000	2,863,625	2,902,800
ENSERCH CORP	7.13	06/15/2005	5,000,000	5,119,606	4,879,700
FMC CORP	6.38	09/01/2003	4,000,000	3,984,312	3,739,360
FIRST BK NATL ASSN	8.35	11/01/2004	5,000,000	4,995,839	5,302,400
FIRST INTST BANCORP MTN BK ENT	9.37	11/18/98	5,000,000	5,036,083	5,268,650
FIRST UN CORP	8.00	08/15/2009	5,000,000	5,262,299	5,082,550
FLORIDA GAS TRANSMISSION CO	9.19	11/01/2024	5,000,000	5,000,000	5,687,900
FORD MTR CR CO	6.75	05/15/2005	3,000,000	3,083,281	2,874,870
GTE CORP	10.75	09/15/2017	1,000,000	986,736	1,091,310
GTE CORP	10.30	11/15/2017	4,000,000	4,000,000	4,382,000
GTE CORP	7.83	05/01/2023	5,000,000	5,090,298	4,913,450
GTE SOUTH INC	7.50	03/15/2026	4,000,000	3,955,414	3,867,600
GENERAL AMERN TRANSN CORP 94 1	8.42	01/01/2015	10,000,000	10,000,000	10,643,000
GENERAL ELEC CAP CORP	6.20	03/15/97	900,000	898,354	902,088
GENERAL TEL CO NORTHWEST INC	8.75	04/15/2016	1,000,000	1,006,351	1,031,660
GEORGIA PAC CORP	9.75	01/15/2018	1,000,000	983,825	1,047,170
GEORGIA PAC CORP	9.13	07/01/2022	2,000,000	1,951,670	2,074,660
GEORGIA PAC CORP	8.25	03/01/2023	10,000,000	10,099,442	9,678,900
HFS INC	5.88	12/15/98	2,500,000	2,496,056	2,438,375
KERR MCGEE CORP	7.00	11/01/2011	1,000,000	912,449	940,050
LONG ISLAND LTG CO	9.75	05/01/2021	3,500,000	3,461,931	3,595,690
LOUISIANA PWR + LT CO	8.50	07/01/2022	1,500,000	1,492,672	1,467,795
LUCKY STORES	16.00	12/10/2001	350,053	350,053	350,053
LUCKY STORES	16.00	10/29/2001	472,662	472,662	472,662
MCI COMMUNICATIONS CORP	7.75	03/23/2025	7,000,000	6,930,279	6,873,580
MDU RES GROUP INC	9.13	10/01/2016	5,000,000	5,000,000	5,369,350
MAY DEPT STORES CO	9.13	12/01/2016	3,000,000	2,843,504	3,088,440
METROPOLITAN LIFE INS CO	7.45	11/01/2023	5,000,000	4,857,718	4,534,050
MISSISSIPPI PWR + LT CO	7.70	07/15/2023	4,000,000	3,958,549	3,720,160
MONTANA PWR CO	7.70	02/01/99	3,000,000	3,071,023	3,028,980
MONTANA PWR CO	8.95	02/01/2022	4,000,000	3,998,235	4,220,880
MONTANA PWR CO	7.00	03/01/2005	2,000,000	1,892,013	1,934,900
NEW YORK ST ELEC + GAS CORP	9.88	11/01/2020	3,800,000	3,762,914	4,393,978
NORTHWEST PIPELINE CORP	9.00	08/01/2022	9,000,000	9,273,619	9,495,810

<u>Security Name</u>		<u>Coupon</u>	<u>Maturity</u>	<u>Par</u>	<u>Book Value</u>	<u>Market Value</u>
OCCIDENTAL PETE CORP MTN		8.75	01/15/2023	4,000,000	4,000,000	4,396,080
OXY USA INC		7.00	04/15/2011	7,000,000	6,442,190	6,404,020
PACIFIC BELL		7.38	06/15/2025	5,000,000	4,877,018	4,731,900
PAINE WEBBER GROUP INC		8.88	03/15/2005	5,000,000	4,982,266	5,377,100
PANHANDLE EASTN PIPE LINE CO		7.95	03/15/2023	5,000,000	4,924,587	4,809,150
PENNZOIL CO		9.63	11/15/99	3,000,000	2,996,458	3,215,220
PHILADELPHIA ELEC CO		6.50	05/01/2003	4,000,000	3,992,584	3,843,280
PHILADELPHIA ELEC CO		7.25	11/01/2024	3,000,000	2,917,323	2,793,810
PHILLIPS PETE CO		9.18	09/15/2021	5,000,000	4,988,220	5,367,000
PHILLIPS PETE CO		8.49	01/01/2023	3,000,000	2,990,535	3,042,600
PHILLIPS PETE CO		7.20	11/01/2023	3,000,000	2,723,700	2,754,090
QUESTAR PIPELINE CO		9.88	06/01/2020	2,500,000	2,489,426	2,728,475
RELIASTER FINL CORP		6.63	09/15/2003	5,500,000	5,493,246	5,171,815
REVLON CONSUMER PRODS CORP		10.88	07/15/2010	2,000,000	1,929,408	2,000,000
ROHR INDS INC		9.25	03/01/2017	2,000,000	2,000,000	1,810,000
S + A RESTAURANT CORP		11.15	08/15/98	4,000,000	4,000,000	4,054,240
SAFE HARBOR WATER PWR CORP		9.35	04/15/2001	2,500,000	2,500,000	2,566,775
SEA LAND SVC INC		10.60	01/02/2011	2,265,000	2,265,000	2,409,892
SEA LAND SVC INC		10.60	01/02/2011	2,000,000	2,000,000	2,127,940
SEARS ROEBUCK + CO		6.25	01/15/2004	5,000,000	4,649,011	4,742,300
SOUTHERN UN CO NEW		7.60	02/01/2024	10,000,000	8,990,154	9,443,300
SOUTHWEST GAS CORP		9.38	02/01/2017	8,600,000	8,460,627	9,028,538
SOUTHWESTERN BELL TEL CO		7.25	07/15/2025	3,000,000	3,090,650	2,819,100
SUNAMERICA INC		8.13	04/28/2023	4,600,000	4,574,292	4,593,698
SUPER VALUE STORE		8.88	11/15/2022	2,000,000	1,998,523	2,079,740
TELE COMMUNICATIONS INC		8.75	02/15/2023	3,500,000	3,514,858	3,302,320
TELE COMMUNICATIONS INC		7.88	08/01/2013	5,000,000	4,903,223	4,555,400
TEXAS EASTN TRANSMISSION CORP		10.13	09/01/2011	2,000,000	1,992,425	2,114,400
TEXAS EASTN TRANSMISSION CORP		10.00	10/01/2011	2,700,000	2,679,895	2,852,739
TEXAS NEW MEX PWR CO		10.00	07/01/2017	3,878,000	3,865,036	3,875,518
TEXAS UTILS ELEC CO		8.88	02/01/2022	2,000,000	2,016,069	2,004,800
TEXAS UTILS ELEC CO		6.38	08/01/97	2,000,000	1,998,255	2,000,540
TEXAS UTILS ELEC CO		7.88	03/01/2023	6,500,000	6,391,894	6,322,160
TEXTRON INC		8.75	07/01/2022	1,500,000	1,591,903	1,567,455
TOLEDO EDISON CO		7.25	08/01/99	4,300,000	4,297,907	4,088,139
TRAILER TRAIN CO		10.30	05/01/2004	2,666,667	2,666,667	2,901,333
TRANSCONTINENTAL GAS PIPE LINE		9.13	02/01/2017	1,500,000	1,444,850	1,560,795
TRI CITY PPTY INVS CORP		13.50	03/01/99	655,071	655,071	709,776
TYCO LABS INC		6.38	01/15/2004	4,000,000	3,976,589	3,751,400
USG CORP		8.75	03/01/2017	6,700,000	6,466,935	6,566,000
UNION OIL CO CA		8.75	08/15/2001	5,000,000	5,249,549	5,373,700
UNION OIL CO CA		7.20	05/15/2005	5,000,000	4,996,710	4,930,800
UNION PAC CORP		8.50	01/15/2017	4,000,000	3,594,727	4,083,120
UNION PAC CORP		6.40	02/01/2006	2,000,000	1,969,257	1,862,000
UNION PAC RR CO		7.75	07/01/2012	4,934,044	4,934,044	5,104,860
U S BANCORP OR		8.13	05/15/2002	5,000,000	4,954,365	5,226,100
U S WEST COMMUNICATIONS INC		7.50	06/15/2023	5,000,000	4,463,648	4,764,050
WESTERN INVT REAL ESTATE TR		7.88	02/15/2004	6,000,000	5,986,698	6,017,820
WESTINGHOUSE ELEC CORP		8.63	08/01/2012	2,000,000	2,095,830	1,930,340
WESTINGHOUSE ELEC CORP		6.88	09/01/2003	1,500,000	1,500,000	1,374,900
WESTVACO CORP		7.00	08/15/2023	5,000,000	4,377,477	4,471,050
WILMINGTON TR TUSCON ELECTRIC		10.21	01/01/2009	5,500,000	5,500,000	5,500,000
CORPORATE OTHER				<u>463,024,350</u>	<u>457,947,026</u>	<u>467,026,444</u>
FED HOME LN PC	G10173	6.00	01/01/2009	4,922,440	4,901,830	4,697,829
FED HOME LN PC	G30006	7.00	07/01/2013	7,965,654	8,036,106	7,943,190

<u>Security Name</u>	<u>Coupon</u>	<u>Maturity</u>	<u>Par</u>	<u>Book Value</u>	<u>Market Value</u>
FEDERAL HOME LN MTG PC REMIC	9.15	10/15/2020	3,173,824	3,121,581	3,280,940
FEDERAL HOME LN MTG PC REMIC	7.00	10/15/97	2,102,300	2,102,212	2,108,859
FEDERAL HOME LN MTG PC REMIC	6.25	11/15/2007	5,012,976	4,893,143	4,911,152
FED HM LN PC E00247	5.50	10/01/2008	5,275,098	5,240,457	4,915,705
FED NATL MTG ASSN REMIC PO	0.00	05/25/2023	2,778,375	2,352,818	2,326,889
FED NATL MTG ASSN REMIC PO	0.00	10/25/2020	3,369,556	2,838,745	2,864,123
FEDERAL NATL MTG ASSN REMIC	8.95	05/25/2003	1,084,815	1,084,673	1,128,544
FNMA POOL 303202	6.50	05/01/2014	13,578,994	13,381,407	12,921,228
GNMA POOL 032974	9.50	09/15/2009	179,247	160,523	192,744
GNMA POOL 038164	10.00	01/15/2010	392,097	389,598	427,260
GNMA POOL 039321	10.00	12/15/2009	189,283	188,080	206,326
GNMA POOL 042547	10.00	10/15/2010	213,519	212,146	232,744
GNMA POOL 065459	11.50	04/15/2013	131,025	128,544	147,709
GNMA POOL 166690	9.00	06/15/2016	181,705	180,085	192,210
GNMA POOL 281467	9.00	09/15/2019	458,014	455,426	483,347
GNMA POOL 302456	9.00	02/15/2021	737,995	736,272	777,891
US GOVERNMENT MORTGAGE-BACKED			<u>51,746,916</u>	<u>50,403,646</u>	<u>49,758,690</u>
FEDERAL NATL MTG ASSN MTN	7.13	04/30/2026	10,000,000	9,711,758	9,839,700
INGENIEROS CIVILES ASOCIADOS	4.90	11/15/98	5,509,000	5,509,000	5,429,064
LIBERTY CRUISE LINE INC	9.85	12/15/2003	932,000	931,345	1,063,775
LITTON HULL 102 SYSTEM	7.38	12/13/98	113,809	113,809	113,809
OXY GROWER XI USGG	8.13	09/16/2006	1,661,000	1,661,000	1,668,923
SHIPCO 668 INC	8.50	05/11/2002	776,000	776,154	776,792
STUDENT LN MARKETING ASSN	0.00	05/15/2014	50,000,000	9,495,284	11,250,000
THIRD ATTRANSO TANKER CORP	8.80	05/01/2008	1,650,000	1,598,445	1,802,922
UNITED STATES TREAS BDS	8.75	11/15/2008	17,000,000	19,181,351	18,856,740
UNITED STATES TREAS BDS	9.13	05/15/2009	17,500,000	18,776,573	19,909,050
UNITED STATES TREAS BDS	9.25	02/15/2016	18,000,000	21,160,042	22,260,960
UNITED STATES TREAS BDS	7.25	05/15/2016	14,000,000	14,752,841	14,328,160
UNITED STATES TREAS BDS	7.50	11/15/2016	16,000,000	17,647,939	16,809,920
UNITED STATES TREAS NTS	8.25	07/15/98	8,400,000	8,765,223	8,732,052
UNITED STATES TREAS NTS	7.88	08/15/2001	7,500,000	7,759,418	7,945,275
UNITED STATES TREAS NTS	7.50	11/15/2001	8,500,000	9,404,093	8,873,235
UNITED STATES TREAS NTS	6.38	08/15/2002	11,000,000	11,442,285	10,912,330
UNITED STATES TREAS NTS	6.25	02/15/2003	13,000,000	13,347,435	12,770,420
UNITED STATES TREAS NTS	7.25	05/15/2004	10,000,000	10,428,162	10,360,900
UNITED STATES TREAS NTS	8.88	02/15/99	3,500,000	3,654,622	3,718,190
UNITED STATES TREAS NTS	9.13	05/15/99	10,000,000	10,505,651	10,726,600
UNITED STATES TREAS NTS	8.75	10/15/97	9,000,000	9,254,037	9,309,330
US GOVERNMENT DIRECT/INDIRECT			<u>234,041,809</u>	<u>205,876,467</u>	<u>207,458,147</u>
ALCAN ALUM LTD	9.63	07/15/2019	4,300,000	4,094,255	4,707,597
AMOCO CDA PETE CO	7.95	10/01/2022	5,000,000	4,664,915	5,078,950
BRITISH COLUMBIA HYDRO + PWR	12.50	09/01/2013	5,200,000	5,211,358	5,989,672
BRITISH COLUMBIA HYDRO + PWR	12.50	01/15/2014	1,000,000	995,436	1,167,690
FORD CAPITAL BV	9.88	05/15/2002	3,000,000	2,976,846	3,391,590
GREAT LAKES PWR INC	9.00	08/01/2004	10,000,000	9,962,147	10,579,800
HYDRO QUEBEC	13.25	12/15/2013	1,400,000	1,400,000	1,648,220
INCO LTD	9.88	06/15/2019	5,000,000	5,041,434	5,410,750
MACMILLAN BLOEDEL LTD	7.70	02/15/2026	5,000,000	4,853,464	4,531,100
NEWS AMER HLDGS INC	8.88	04/26/2023	5,000,000	5,719,830	5,187,200
PHILIPS ELEC NV	6.75	08/15/2003	5,000,000	4,845,999	4,817,350
TRANSCANADA PIPELINES LTD	8.50	03/20/2023	5,000,000	5,392,101	5,288,250

<u>Security Name</u>	<u>Coupon</u>	<u>Maturity</u>	<u>Par</u>	<u>Book Value</u>	<u>Market Value</u>
YANKEE BONDS			<u>54,900,000</u>	<u>55,157,785</u>	<u>57,798,169</u>
BOND ANTICIPATION NOTES	7.5-9.92	11/15/96-99	3,254,679	3,254,679	3,254,679
ECONOMIC ST BRD INVT DEV REV	11.20	11/15/99	55,000	55,000	57,330
HILL CNTY MT ELEM SCH DIST 16	6.38	12/01/2001	1,805,000	1,805,000	1,749,586
MONTANA ST COAL SEVERANCE TAX	9.50	12/01/2001	2,490,000	2,490,000	2,493,811
YELLOWSTONE CNTY MT	7.10	06/01/99	844,999	843,560	845,473
YELLOWSTONE CNTY MT	7.35	06/01/00	499,999	499,010	500,500
STATE/LOCAL GOVERNMENT			<u>8,949,678</u>	<u>8,947,249</u>	<u>8,901,379</u>
SHORT TERM INVESTMENT POOL			<u>34,228,135</u>	<u>34,228,135</u>	<u>34,228,135</u>
TOTAL TRUST FUND BOND POOL PORTFOLIO			<u>\$873,112,178</u>	<u>\$838,465,319</u>	<u>\$850,970,143</u>

Independent Auditor's Report & Montana Stock Pool Financial Statements

MONTANA LEGISLATIVE BRANCH

Legislative Auditor
Scott A. Seacat

Legal Counsel:
John Northey



Deputy Legislative Auditors:
Mary Bryson
Operations and EDP Audit
James Gillett
Financial-Compliance Audit
Jim Pellegrini
Performance Audit

LEGISLATIVE AUDIT DIVISION

INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the accompanying Statement of Net Asset Value for the state of Montana Board of Investments, Montana Stock Pool, as of June 30, 1996 and 1995, and the related Statement of Changes in Net Asset Value and Statement of Investment Income and Distribution for the two fiscal years then ended. These financial statements are the responsibility of the Board of Investments' management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net asset value of the state of Montana Board of Investments, Montana Common Stock Pool, as of June 30, 1996 and 1995, and its changes in net asset value and investment income and distributions for the fiscal years then ended in conformity with generally accepted accounting principles.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "James Gillett".

James Gillett, CPA
Deputy Legislative Auditor

October 4, 1996

**STATE OF MONTANA BOARD OF INVESTMENTS
MONTANA STOCK POOL FINANCIAL STATEMENTS**

STATEMENT OF NET ASSET VALUE, JUNE 30, 1996 AND 1995

	<u>1996</u>	<u>1995</u>
<u>Assets</u>		
Cash	\$ 0	\$ 282
Dividend receivable	1,953,914	2,570,644
Interest receivable	293,875	20,577
Investments managed at current value (amortized cost of \$1,007,556,081 in 1996 and \$896,200,984 in 1995) (Notes 2 and 4)	<u>1,320,537,965</u>	<u>1,059,611,664</u>
Total assets	<u>1,322,785,754</u>	<u>1,062,203,167</u>
<u>Liabilities</u>		
Income due participants	2,880,291	2,324,820
Broker payable for securities purchased but not settled (Note 2)	<u>0</u>	<u>3,092,125</u>
Total liabilities	<u>2,880,291</u>	<u>5,416,945</u>
Net asset value	<u>\$1,319,905,463</u>	<u>\$1,056,786,222</u>
Units Outstanding	2,861,546	2,770,130
Unit Value	\$461	\$381

**STATEMENT OF CHANGES IN NET ASSET VALUE
FOR THE FISCAL YEARS ENDED JUNE 30, 1996 AND 1995**

Net asset value, beginning of year	\$1,056,786,222	\$ 852,214,778
Value of units purchased by participants (Note 2)	39,365,335	48,669,723
Value of units sold by participants	(297,916)	0
Changes in current value of investments managed	<u>224,051,822</u>	<u>155,901,721</u>
Net asset value, end of year	<u>\$1,319,905,463</u>	<u>\$1,056,786,222</u>

**STATEMENT OF INVESTMENT INCOME AND DISTRIBUTION
FOR THE FISCAL YEARS ENDED JUNE 30, 1996 AND 1995**

Investment income	\$33,953,434	\$29,606,071
Administrative expenses	(436,241)	(496,713)
Income due participants, beginning of year	<u>2,324,820</u>	<u>149,274</u>
Income available for distribution	35,842,013	29,258,632
Distribution (Note 2)	<u>32,961,722</u>	<u>26,933,812</u>
Income due participants, end of year	<u>\$ 2,880,291</u>	<u>\$ 2,324,820</u>

The accompanying notes are an integral part of these financial statements.

STATE OF MONTANA BOARD OF INVESTMENTS
MONTANA STOCK POOL - NOTES TO FINANCIAL STATEMENTS

JUNE 30, 1996 AND 1995

1. HISTORY AND ORGANIZATION

The Board was created by an act of the Legislature to invest and manage the State of Montana's investment funds on a centralized basis. The Montana Common Stock Pool (Montcomp) was created, by the Board, to allow retirement and endowment funds, per section 17-6-201, MCA, the opportunity to participate in the equity market via a diversified pool. Montcomp was created as of July 1, 1980, by the transfer of all common stock owned by the Public Employees' Retirement System, Teachers' Retirement System, and other funds into Montcomp.

In March 1996, the Board approved the Investment Policy Statement to reflect the name change from the Montana Common Stock Pool to the Montana Stock Pool. This policy statement provided for the investment in common or preferred stock. The Investment Policy Statement was revised and approved in September 1996 to allow the investment in securities convertible into common or preferred stocks.

Due to the liquidation of the Montana Convertible Securities Pool (MTCVP) in June 1996, the Montana Stock Pool bought \$44,246,291 in convertible debt and equity securities from MTCVP. These securities were retained, internally by the Board, as quality investments benefiting the Montcomp participants.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Investments

Montcomp investments are purchased in accordance with the statutorily mandated "Prudent Expert Principle". The Montcomp portfolio includes common stock, convertible corporate debt consisting of coupon and zero coupon bonds and convertible equity securities. Common stock represents ownership units (shares) of a public corporation. Common stock owners are entitled to vote on director selection and other important matters as well as receive dividends on their holdings. Convertible securities are securities carrying the right to exchange, or "convert" the instrument for other securities of the issuer or of another issuer. This definition most often applies to preferred stocks or corporate bonds carrying the right to exchange for a fixed number of shares of the issuer's common stock. Zero coupon bonds, sold at a deep discount from par, make no periodic coupon payments.

As of June 30, 1996, the Montcomp investments include three convertible security holdings whose structure differ from the basic corporate convertible preferred structure. These security structures, with a June 30, 1996 amortized cost of \$5,636,875, include ACEs (Automatically Convertible Equity Security) and DEC's (Dividend Enhanced Common Stock). ACEs and DEC's are issued at a premium to the underlying common stock in exchange for a higher dividend yield. These securities, purchased for portfolio diversification and rate of return, are reported as preferred stocks in the investment risk and portfolio disclosures. (See Note 4 on Investment Risk Categories and Note 5 for the Year End Portfolio.)

Investments are presented in the statement of Net Asset Value at current value. Current values for publicly traded convertible debt securities are determined primarily by reference to market prices supplied to the Board by the Board's custodial bank, State Street Bank, or various brokerage services. Equity investments, traded on a national security exchange, are stated at the last reported sales price on valuation day, while equity securities traded in the over-the-counter market are stated at the last quoted bid price. Amortized cost, parenthetically disclosed, represents the original convertible debt cost adjusted for premium and discount amortization and the equity security purchase price plus a fixed commission where applicable. Premiums and discounts are amortized using an interest method over the life of the security.

Participant Units

The Public Employees' Retirement System and the Teachers' Retirement System transferred all stock owned into Montcomp at the start-up date and were issued units according to the market value of their contribution, retaining their original total cost basis. The initial unit value as of July 1, 1980, was \$1,000. Unit values thereafter are calculated once a month at the close of the last business day of the month, based upon the market value of the Montcomp equity holdings and other assets. Based on the investment officers' decision, participants may then buy or sell units on the first business day of each month. Depending on the stock market conditions and the investment officers' analysis, unit values may be calculated during the month to permit participants to buy or sell units the following business day.

On July 1, 1994, the initial unit value changed from \$1,000 to \$100. This change was required for the Board's new accounting system.

As reported in the Statement of Changes in Net Asset Value, the value of units purchased by participants decreased from \$48.6 million in fiscal year 1995 to \$39.3 million in fiscal year 1996. This decrease is the result of an investment strategy decision not to buy into a stock market viewed to be fully priced and does not reflect a change from the stated investment policy to increase retirement fund exposure to common stock investments.

Broker Receivable/Payable

Montcomp security transactions are recorded as of the trade date rather than the settlement date. Because of this generally accepted practice, the Montcomp portfolio at June 30 could include receivables from brokers for securities sold but not delivered, and payables to brokers for securities purchased but not received.

Other

Montcomp dividends are recorded on the ex-dividend date.

3. SECURITIES LENDING

The Board has an agreement with the custodial bank whereby the bank lends securities managed by the Board. State Street Bank was appointed the Board's custodial bank on December 1, 1993. During the period the securities are on loan, the Board receives a fee and the bank must maintain collateral equal to 102 percent of the market value of the securities on loan. The Board retains all rights and risks of ownership during the loan period.

Securities lending income was \$333,137 for fiscal year 1996 and \$166,270 for fiscal year 1995. On June 30, 1996 and 1995, respectively, \$122,664,052 and \$63,796,011 in securities were on loan to other entities.

4. INVESTMENT RISK CATEGORIES

State of Montana investments are categorized below to give an indication of the level of risk assumed at June 30, 1996 and June 30, 1995. Category 1 includes investments that are insured or registered, or securities that are held by the Board or its agent in the Board's name. Category 2 includes uninsured and unregistered investments, with securities held by the counterparty trust department or agent in the Board's name.

Risk as of June 30, 1996

<u>Investment Type</u>	<u>Category 1</u>	<u>Category 2 *</u>	<u>Carrying Amount</u>	<u>Market Value</u>
Common Stocks	\$804,352,588	\$118,759,205	\$ 923,111,793	\$1,236,626,271
Preferred Stocks	16,637,527	3,003,750	19,641,277	19,445,653
Convertible Bonds	17,155,111	901,097	18,056,208	17,953,125
Zero Coupon Bonds	6,963,887	0	6,963,887	6,730,000
STIP	<u>39,782,916</u>	<u>0</u>	<u>39,782,916</u>	<u>39,782,916</u>
Total Investment	<u>\$884,892,029</u>	<u>\$122,664,052</u>	<u>\$1,007,556,081</u>	<u>\$1,320,537,965</u>

Risk as of June 30, 1995

<u>Investment Type</u>	<u>Category 1</u>	<u>Category 2 **</u>	<u>Carrying Amount</u>	<u>Market Value</u>
Common Stocks	\$755,853,966	\$63,796,011	\$819,649,977	\$ 983,060,657
STIP	<u>76,551,007</u>	<u>0</u>	<u>76,551,007</u>	<u>76,551,007</u>
Total Investment	<u>\$832,404,973</u>	<u>\$63,796,011</u>	<u>\$896,200,984</u>	<u>\$1,059,611,664</u>

* At June 30, 1996, these securities with a market value of \$134,727,649 were loaned under a securities lending agreement with the state's agent.

** At June 30, 1995, these securities with a market value of \$66,156,247 were loaned under a securities lending agreement with the state's agent.

5. YEAR END PORTFOLIO

The June 30, 1996 Montcomp portfolio is listed below.

MTCP PORTFOLIO AS OF JUNE 30, 1996

<u>Security Name</u>	<u>Coupon</u>	<u>Maturity</u>	<u>Shares/Par</u>	<u>Amortized Cost</u>	<u>Market Value</u>
AT + T CORP			330,000	11,312,979	20,460,000
ABBOTT LABS			540,000	8,506,137	23,490,000
ALLIED SIGNAL INC			100,000	3,380,070	5,712,500
ALLSTATE CORP			296,651	7,516,570	13,534,702
AMERICAN EXPRESS CO			315,800	9,020,058	14,092,575
AMGEN INC			45,000	2,053,323	2,430,000
AMP INC			350,000	13,218,091	14,043,750

<u>Security Name</u>	<u>Coupon</u>	<u>Maturity</u>	<u>Shares/Par</u>	<u>Amortized Cost</u>	<u>Market Value</u>
AMOCO CORP			80,000	4,841,040	5,790,000
ARCHER DANIELS MIDLAND CO			982,500	12,757,128	18,790,313
ARGENTINA FD INC			100,000	1,188,295	1,300,000
ASSOCIATED ESTATES RLTY CORP			285,000	5,642,400	5,985,000
AUSTRIA FD INC			280,000	2,241,635	2,555,000
AUTOMATIC DATA PROCESSING INC			160,000	3,798,400	6,180,000
BANC ONE CORP			484,000	12,232,242	16,456,000
BANKAMERICA CORP			230,000	9,942,287	17,422,500
BETHLEHAM STL CORP			1,110,000	17,286,112	13,181,250
BRISTOL MYERS SQUIBB CO			60,000	3,229,769	5,400,000
BROWNING FERRIS INDS INC			410,000	12,648,320	11,890,000
BURLINGTON NORTHN SANTA FE			160,000	8,187,778	12,940,000
BURLINGTON RES INC			190,000	8,017,223	8,170,000
CAREMARK INTL INC			700,000	14,806,699	17,675,000
CATERPILLAR INC			230,000	12,344,335	15,582,500
CEMEX SA			1,320,000	14,217,684	10,413,876
CHASE MANHATTAN CORP NEW			30,000	1,970,550	2,118,750
CHUBB CORP			198,400	7,674,267	9,895,200
CIBA GEIGY A G			300,000	7,479,305	18,275,970
CITICORP			110,000	4,918,358	9,088,750
DEERE + CO			140,000	3,124,590	5,600,000
DEVELOPERS DIVERSIFIED RLTY			210,000	6,083,152	6,693,750
DRESSER INDS INC			310,000	6,377,325	9,145,000
DU PONT E I DE NEMOURS + CO			240,000	14,517,961	18,990,000
DUKE RLTY INVTs INC			160,000	4,835,400	4,840,000
EASTMAN KODAK CO			80,000	3,723,280	6,220,000
EMERGING GERMANY FD INC			200,000	1,460,000	1,475,000
EMERSON ELEC CO			120,000	7,181,797	10,845,000
EMPRESAS ICA SOCIEDAD CONTROL			360,000	5,467,337	4,995,000
ENRON CORP			180,000	5,452,020	7,357,500
EXXON CORP			129,100	7,603,293	11,215,563
FELCOR SUITE HOTELS INC			70,000	2,162,450	2,135,000
FIRST AUSTRALIA FD INC			86,000	660,612	790,125
FIRST UN CORP			331,700	11,247,615	20,192,238
FLEET FINL GROUP INC			310,700	9,234,765	13,515,450
FLUOR CORP			120,000	5,266,840	7,845,000
FORD MTR CO DEL			523,100	12,383,503	16,935,363
FRANCE GROWTH FD INC			520,000	5,340,818	5,330,000
GTE CORP			420,000	10,395,265	18,795,000
GENERAL ELEC CO			370,000	11,856,098	32,005,000
GENERAL INSTRUMENT CORP			10,653	313,720	307,598
GENERAL MTRS CORP			160,000	6,962,100	8,380,000
GENERAL SIGNAL CORP			205,000	6,970,779	7,764,375
GOODYEAR TIRE AND RUBBER			460,000	16,806,788	22,195,000
HANSON PLC			1,212,000	20,089,261	17,271,000
HEWLETT PACKARD CO			100,000	10,014,750	9,962,500
INTEL CORP			420,000	13,513,999	30,843,750
INTERNATIONAL BUSINESS MACHS			100,000	10,585,880	9,900,000
INTERNATIONAL PAPER CO			155,000	5,417,298	5,715,625
JOHNSON + JOHNSON			320,000	6,178,044	15,840,000
MAY DEPT STORES CO			100,000	2,492,662	4,375,000
MERCK + CO INC			340,000	8,203,844	21,972,500
MERRY LAND AND INVT CO			300,000	6,177,500	6,300,000
MOBIL CORP			98,000	8,846,713	10,988,250
MONTANA PWR CO			260,000	5,689,462	5,785,000

<u>Security Name</u>	<u>Coupon</u>	<u>Maturity</u>	<u>Shares/Par</u>	<u>Amortized Cost</u>	<u>Market Value</u>
MOTOROLA INC			370,000	21,116,366	23,263,750
NESTLE S A			220,000	9,103,437	12,558,700
NEW GERMANY FD INC			350,000	4,240,917	4,418,750
NOKIA CORP			800,000	32,037,431	29,600,000
NORFOLK SOUTHN CORP			160,000	9,737,474	13,560,000
NORWEST CORP			410,000	6,773,873	14,298,750
NOVELL INC			450,000	10,954,135	6,243,750
OWENS CORNING			680,000	27,851,120	29,240,000
PNC BK CORP			480,000	12,569,669	14,280,000
PAYLESS SHOESOURCE INC			16,000	250,748	508,000
PENNEY J C INC			120,000	5,463,450	6,300,000
PEPSICO INC			340,000	3,078,076	12,027,500
RECKSON ASSOCS RLTY CORP			180,000	4,646,250	5,940,000
REPSOL S A			180,000	5,648,872	6,255,000
ROUSE CO			250,000	5,054,131	6,468,750
ROYAL DUTCH PETE CO			70,000	6,287,575	10,762,500
SBC COMMUNICATIONS INC			145,000	5,647,377	7,141,250
SAFeway INC			300,000	7,612,500	9,900,000
ST PAUL COS INC			230,000	12,615,551	12,305,000
SARA LEE CORP			320,000	7,726,019	10,360,000
SCHERING PLOUGH CORP			320,000	8,814,700	20,080,000
SCHLUMBERGER LTD			45,000	2,629,578	3,791,250
SCUDDER NEW ASIA FD INC			329,100	5,072,357	4,813,088
SEARS ROEBUCK + CO			150,000	4,104,767	7,293,750
SIGMA ALDRICH			230,000	8,298,475	12,305,000
SIMON PPTY GROUP INC			250,000	5,962,393	6,125,000
SMITHKLINE BEECHAM P L C			130,000	2,139,147	7,068,750
SPIEKER PPTYS INC			160,000	4,122,500	4,360,000
SYSCO CORP			200,000	5,555,297	6,850,000
TAUBMAN CENTERS INC			195,900	2,220,369	2,179,388
TELEFONICA DE ESPANA S A			230,000	8,733,936	12,678,750
TELEFONOS DE MEXICO S A			490,000	19,973,763	16,415,000
TEMPLE INLAND INC			120,000	4,849,344	5,610,000
TEXACO INC			140,000	8,358,207	11,742,500
TEXAS INSTRS INC			510,000	26,566,856	25,436,250
TIME WARNER INC			130,000	4,736,185	5,102,500
TOYS R US INC			300,000	7,919,147	8,550,000
TRAVELERS GROUP INC			585,000	14,215,968	26,690,625
TYCO INT LTD			360,000	5,976,222	14,670,000
USX MARATHON GROUP			280,000	5,843,753	5,635,000
UNITED DOMINION RLTY TR INC			300,000	4,321,200	4,312,500
UNITED HEALTHCARE CORP			220,000	11,812,680	11,110,000
U S HEALTHCARE INC			750,000	24,424,810	41,250,000
U S WEST INC			250,000	4,210,049	4,562,500
UNITED TECHNOLOGIES CORP			60,000	3,666,933	6,900,000
WMX TECHNOLOGIES INC			190,000	6,463,255	6,222,500
WEINGARTEN RLTY INVS			152,800	5,755,408	5,921,000
YPF SOCIEDAD ANONIMA			1,250,000	24,881,553	28,125,000
TOTAL COMMON STOCKS			<u>32,917,404</u>	<u>923,111,793</u>	<u>1,236,626,271</u>
ALLSTATE CORP - DEC			50,000	1,918,750	1,975,000
BETHLEHAM STL CORP			40,000	1,690,000	1,670,000
BROWNING FERRIS INDS INC - ACE			90,000	3,003,750	2,857,500
CITIZENS UTILS TR			15,000	723,750	723,750

<u>Security Name</u>	<u>Coupon</u>	<u>Maturity</u>	<u>Shares/Par</u>	<u>Amortized Cost</u>	<u>Market Value</u>
ELSAG BAILEY FINANCING TRUST			50,000	2,562,500	2,462,500
FELCOR SUITE HOTELS INC			40,000	1,000,000	1,000,000
FISHER SCIENTIFIC INTL INC			1	27	28
INTERPOOL INC			20,000	1,830,000	1,900,000
REYNOLDS METALS CO - DEC			15,000	714,375	695,625
ST PAUL CAPITAL LLC			30,000	1,563,750	1,575,000
TCI COMMUNICATIONS			35,000	1,579,375	1,544,375
USX MARATHON GROUP			25,000	1,112,500	1,090,625
UNOCAL CORP			35,000	1,942,500	1,951,250
TOTAL PREFERRED STOCKS			<u>445,001</u>	<u>19,641,277</u>	<u>19,445,653</u>
TOTAL STOCKS			<u>33,362,405</u>	<u>942,753,070</u>	<u>1,256,071,924</u>
ALTERA CORP	5.75	06/15/02	1,000,000	1,014,965	1,255,000
AMSCO INTL INC	6.50	10/15/02	2,000,000	1,990,091	2,000,000
CEMEX	4.25	11/01/97	2,250,000	2,083,192	2,070,000
E M C CORP MASS	4.25	01/01/01	2,000,000	2,405,718	2,135,000
EMPRESAS ICA SOCIEDAD CONTRL	5.00	03/15/04	2,000,000	1,332,590	1,270,000
NACIONAL FINANCIER	11.25	05/15/98	37,500	1,265,625	1,293,750
NOVACARE INC	5.50	01/15/00	2,500,000	2,178,724	2,200,000
PRICE CO	6.75	03/01/01	1,500,000	1,566,956	1,623,750
SYNOPTICS COMMUNICATIONS INC	5.25	05/15/03	500,000	468,300	445,000
TELE COMMUNICATIONS INTL INC	4.50	02/15/06	1,000,000	895,400	863,750
TEXAS INSTRUMENTS	2.75	09/29/02	750,000	969,532	916,875
USX MARATHON GROUP	7.00	06/15/17	2,000,000	1,885,115	1,880,000
TOTAL CONVERTIBLE BONDS			<u>17,537,500</u>	<u>18,056,208</u>	<u>17,953,125</u>
MOTOROLA INC	0.00	09/27/13	2,000,000	1,625,906	1,560,000
ROCHE HLDGS INC	0.00	04/20/10	4,000,000	1,745,001	1,690,000
SILICON GRAPHICS INC	0.00	11/02/13	3,000,000	1,577,718	1,500,000
UNITED STATES CELLULAR CORP	0.00	06/15/15	6,000,000	2,015,262	1,980,000
TOTAL ZERO COUPON BONDS			<u>15,000,000</u>	<u>6,963,887</u>	<u>6,730,000</u>
SHORT TERM INVESTMENT POOL			<u>39,782,916</u>	<u>39,782,916</u>	<u>39,782,916</u>
TOTAL MTCP			<u>\$105,682,821</u>	<u>\$1,007,556,081</u>	<u>1,320,537,965</u>

Independent Auditor's Report & Montana Convertible Securities Pool Financial Statements

MONTANA LEGISLATIVE BRANCH

Legislative Auditor
Scott A. Seacat

Legal Counsel:
John Northey



Deputy Legislative Auditors:
Mary Bryson
Operations and EDP Audit
James Gillett
Financial-Compliance Audit
Jim Pellegrini
Performance Audit

LEGISLATIVE AUDIT DIVISION

INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the accompanying Statement of Net Asset Value for the state of Montana Board of Investments, Montana Convertible Securities Pool, as of June 30, 1996 and 1995, and the related Statement of Changes in Net Asset Value and Statement of Investment Income and Distribution for the two fiscal years then ended. These financial statements are the responsibility of the Board of Investments' management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net asset value of the state of Montana Board of Investments, Montana Convertible Securities Pool, as of June 30, 1996 and 1995, and its changes in net asset value and investment income and distributions for the fiscal years then ended in conformity with generally accepted accounting principles.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "James Gillett".

James Gillett, CPA
Deputy Legislative Auditor

October 4, 1996

**STATE OF MONTANA BOARD OF INVESTMENTS
MONTANA CONVERTIBLE SECURITIES POOL FINANCIAL STATEMENTS**

STATEMENT OF NET ASSET VALUE, JUNE 30, 1996 AND 1995

	<u>1996</u>	<u>1995</u>
<u>Assets</u>		
Cash	\$ 0	\$ 390
Interest and dividend receivable	32,416	1,025,676
Investments managed at current value (amortized cost of \$100,704,094 in 1996 and \$95,989,428 in 1995) (Notes 2 and 4)	<u>100,704,094</u>	<u>95,020,651</u>
Total assets	<u>100,736,510</u>	<u>96,046,717</u>
<u>Liabilities</u>		
Income due participants	431,664	573,317
Broker payable for securities purchased but not settled (Note 2)	<u>0</u>	<u>712,500</u>
Total liabilities	<u>431,664</u>	<u>1,285,817</u>
Net asset value	<u>\$100,304,846</u>	<u>\$94,760,900</u>
Units Outstanding	946,000	946,000
Unit Value	\$106	\$100

**STATEMENT OF CHANGES IN NET ASSET VALUE
FOR THE FISCAL YEAR ENDED JUNE 30, 1996 AND 1995**

Net asset value, beginning of year	\$ 94,760,900	\$76,024,711
Value of units purchased by participants	0	14,030,500
Value of units sold by participants	0	0
Changes in current value of investments managed	<u>5,543,946</u>	<u>4,705,689</u>
Net asset value, end of year	<u>\$100,304,846</u>	<u>\$94,760,900</u>

**STATEMENT OF INVESTMENT INCOME AND DISTRIBUTION
FOR THE FISCAL YEAR ENDED JUNE 30, 1996 AND 1995**

Investment income	\$5,875,410	\$5,755,032
Administrative expenses	(178,998)	(206,214)
Income due participants, beginning of year	<u>573,317</u>	<u>3,045</u>
Income available for distribution	6,269,729	5,551,863
Distribution	<u>5,838,065</u>	<u>4,978,546</u>
Income due participants, end of year	<u>\$ 431,664</u>	<u>\$ 573,317</u>

The accompanying notes are an integral part of these financial statements.

STATE OF MONTANA BOARD OF INVESTMENTS
MONTANA CONVERTIBLE SECURITIES POOL

NOTES TO FINANCIAL STATEMENTS
JUNE 30, 1996 AND 1995

1. HISTORY AND ORGANIZATION

The Board was created by an act of the Legislature to invest and manage the State of Montana's investment funds on a centralized basis. The Montana Convertible Securities Pool (MTCVP) was created by the Board to allow qualifying funds, per Section 17-6-201, MCA, to participate in a diversified pool. The MTCVP was created as of March 1, 1993 by the transfer of all convertible bonds owned by the Public Employees' Retirement System (PERS) and Teachers' Retirement System (TRS). On October 1, 1993, \$12,983,250 in convertible preferred stocks owned by the PERS and TRS were bought by the MTCVP.

On June 6, 1996, the Board approved liquidation of the MTCVP and creation of an international equity pool. This action resulted in the sale of all convertible corporate debt and equity securities. The Montana Stock Pool purchased, internally, \$44,246,291 in convertible debt and equity securities, while the remaining convertible debt and equity securities were sold externally. Proceeds from the sale of securities were invested in the Short Term Investment Pool (STIP). As of June 30, 1996, the MTCVP reported a STIP investment of \$100,704,094 and no convertible corporate debt or equity security holdings.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Investments

MTCVP investments are purchased in accordance with the "Prudent Expert Principle". The MTCVP portfolio included convertible corporate debt consisting of coupon and zero coupon bonds and convertible equity securities. Convertible securities are securities carrying the right to exchange, or "convert" the instrument for other securities of the issuer or of another issuer. This definition most often applies to preferred stocks or corporate bonds carrying the right to exchange for a fixed number of shares of the issuer's common stock. Zero coupon bonds, sold at a deep discount from par, make no periodic coupon payments.

As of June 30, 1995, the MTCVP investments included four convertible security holdings whose structure differed from the basic corporate convertible bond/preferred structure. These security structures, with a June 30, 1995 carrying amount and market value, respectively, of \$3,761,484 and \$3,765,000, included PENs (Participating Equity Notes), PERCs (Preferred Equity Redemption Coupons) and DEC's (Dividend Enhanced Common Stock). PENs are corporate bonds offering the investor a choice at maturity of receiving the greater of the bond's par or the value of a preset ratio of an established index. PERCs reflect an investor's acceptance of a cap in a security's price appreciation in exchange for a higher income yield. DEC's are issued, and traded, at a premium to the underlying common stock in exchange for a higher dividend yield. These securities, purchased for portfolio diversification and rate of return, are reported as zero coupon bonds and preferred stocks in the investment risk disclosure. (See Note 4 on Investment Risk Categories.)

Investments are presented in the Statement of Net Asset value at current value. Current values for publicly traded securities are determined primarily by reference to market prices supplied to the Board by the Board's custodial bank, State Street Bank, or various brokerage services. Amortized cost, parenthetically disclosed, represents the original cost adjusted for premium and discount amortization where applicable. Premiums and discounts are amortized using an interest method over the life of the security.

Participant Units

The Public Employees' Retirement System and the Teachers' Retirement System transferred all convertible bonds into the MTCVP at the start-up date and were issued units according to the market value of their contribution. Unit values are calculated once a month at the close of the last business day of the month based upon the market value of the MTCVP bond and preferred stock holdings and other assets. Based on the investment officers' decision, participants may then buy or sell units on the first business day of each month.

Broker Receivable/Payable

Convertible security transactions are recorded as of the trade date rather than the settlement date. Because of this generally accepted practice, the convertible portfolio at June 30 could include receivables from brokers for securities sold but not delivered and payables to brokers for securities purchased but not received.

Other

The portfolio gains/losses are retained rather than distributed to participants at month end.

3. SECURITIES LENDING

The Board has an agreement with the custodial bank whereby the bank lends to other entities securities managed by the Board. State Street Bank was appointed the Board's custodial bank on December 1, 1993. During the period the securities are on loan, the Board receives a fee and the bank must maintain collateral equal to 102 percent of the market value of the securities on loan. The Board retains all rights and risks of ownership during the loan period. Securities lending income was \$30,365 for fiscal year 1996 and \$49,933 for fiscal year 1995. On June 30, 1995, \$10,248,792 in securities were on loan to other entities. No securities were on loan as of June 30, 1996.

4. INVESTMENT RISK CATEGORIES

State of Montana investments are categorized below to give an indication of the level of risk assumed at June 30, 1996 and 1995. Category 1 includes investments that are insured or registered, or securities that are held by the Board or its agent in the Board's name. Category 2 includes uninsured and unregistered investments, with securities held by the counterparty trust department or agent in the Board's name.

<u>Investment Type</u>	Risk as of June 30, 1996		<u>Carrying Amount</u>	<u>Market Value</u>
	<u>Category 1</u>	<u>Category 2 *</u>		
STIP	<u>\$100,704,094</u>	<u>0</u>	<u>\$100,704,094</u>	<u>\$100,704,094</u>
Total Investment	<u>\$100,704,094</u>	<u>\$ 0</u>	<u>\$100,704,094</u>	<u>\$100,704,094</u>

<u>Investment Type</u>	Risk as of June 30, 1995		<u>Carrying Amount</u>	<u>Market Value</u>
	<u>Category 1</u>	<u>Category 2 **</u>		
Convertible Bonds	<u>\$45,272,856</u>	<u>\$ 3,501,526</u>	<u>\$48,774,382</u>	<u>\$48,395,000</u>
Zero Coupon Bonds	<u>9,487,373</u>	<u>2,280,802</u>	<u>11,768,175</u>	<u>12,270,000</u>
Preferred Stocks	<u>16,103,144</u>	<u>4,466,464</u>	<u>20,569,608</u>	<u>19,478,388</u>
STIP	<u>14,877,263</u>	<u>0</u>	<u>14,877,263</u>	<u>14,877,263</u>
Total Investment	<u>\$85,740,636</u>	<u>\$10,248,792</u>	<u>\$95,989,428</u>	<u>\$95,020,651</u>

* At June 30, 1996, there were no securities loaned under a securities lending agreement with the state's agent.

** At June 30, 1995, these securities with a market value of \$10,264,641 were loaned under a securities lending agreement with the state's agent.

The Board of Investment's policy required MTCVP convertible debt and zero coupon bonds, at time of purchase, to be rated Baa3 or higher by Moody's and/or BBB- or higher by Standard & Poor's (S&P) on a market-weighted average as a credit risk control measure.

The above securities carried market risk and the potential for change in market value. Causes for market value changes included interest rate changes, a decline in the value of the underlying common stock, a change or a perceived change of an issuer's credit quality, the triggering of a call feature and other factors.

There are no legal risks that the Board is aware of regarding any MTCVP investments.

5. YEAR END PORTFOLIO

The June 30, 1996 MTCVP portfolio is listed below.

MTCVP PORTFOLIO AS OF JUNE 30, 1996

<u>Security Name</u>	<u>Par/Shares</u>	<u>Amortized Cost</u>	<u>Market Value</u>
SHORT TERM INVESTMENT POOL	<u>100,704,094</u>	<u>100,704,094</u>	<u>100,704,094</u>
TOTAL MTCVP	<u>100,704,094</u>	<u>100,704,094</u>	<u>100,704,094</u>

6. LIQUIDATION OF THE MONTANA CONVERTIBLE SECURITIES POOL

In July 1996, the June 30, 1996 income due participants of \$431,664 was paid to the MTCVP participants. Also in July, the pool's STIP investment of \$100,704,094 was liquidated and the related STIP earnings of \$21,054 were distributed to the MTCVP participants as of

August 1, 1996. All 946,000 units outstanding of the MTCVP were sold in July 1996 at a price of \$106 resulting in the distribution of the pool's accumulated portfolio gains of \$5,631,698 to the MTCVP participants. As of August 31, 1996, all accounts related to the Montana Convertible Securities Pool reported a zero balance.

Independent Auditor's Report & All Other Funds Financial Statements

MONTANA LEGISLATIVE BRANCH

Legislative Auditor
Scott A. Seacat

Legal Counsel:
John Northey



Deputy Legislative Auditors:
Mary Bryson
Operations and EDP Audit
James Gillett
Financial-Compliance Audit
Jim Pellegrini
Performance Audit

LEGISLATIVE AUDIT DIVISION

INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the accompanying Statement of Investments Managed for the state of Montana Board of Investments, All Other Funds, as of June 30, 1996 and 1995, and the related Statement of Investment Income and Statement of Changes in Investments Managed for the two fiscal years then ended. These financial statements are the responsibility of the Board of Investments' management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the investments managed by the state of Montana Board of Investments, All Other Funds, as of June 30, 1996 and 1995, and its investment income and changes in its investments managed for the fiscal years then ended in conformity with generally accepted accounting principles.

Respectfully submitted,

A handwritten signature in cursive script that reads "James Gillett".

James Gillett, CPA
Deputy Legislative Auditor

October 4, 1996

**STATE OF MONTANA BOARD OF INVESTMENTS
ALL OTHER FUNDS FINANCIAL STATEMENTS**

STATEMENT OF INVESTMENTS MANAGED, JUNE 30, 1996 AND 1995

	<u>1996</u>	<u>1995</u>
<u>Assets</u>		
Investments managed at current value (amortized cost of \$1,034,006,169 in 1996 and \$1,703,882,415 in 1995) (Notes 2, 7 and 9)	\$1,050,276,071	\$1,763,408,037
Net unamortized deferred losses on bond swaps (Note 2)	0	0
Interest receivable	<u>13,477,536</u>	<u>37,890,441</u>
Total assets	<u>1,063,753,607</u>	<u>1,801,298,478</u>
<u>Liabilities</u>		
Unrealized gain (loss)	<u>16,269,902</u>	<u>59,525,623</u>
Total liabilities	<u>16,269,902</u>	<u>59,525,623</u>
Net investments managed	<u>\$1,047,483,705</u>	<u>\$1,741,772,855</u>

**STATEMENT OF INVESTMENT INCOME
FOR THE FISCAL YEARS ENDED JUNE 30, 1996 AND 1995**

<u>Income</u>		
Investment income (Note 8)	\$ 80,746,733	\$ 205,218,577
Realized gain on sales	12,137,776	902,321
Amortization/accretion	(1,296,341)	(604,818)
Accumulated deferred loss (Note 2)	<u>0</u>	<u>(3,178,396)</u>
Total income	<u>91,588,168</u>	<u>202,337,684</u>
<u>Expenses</u>		
Administrative expenses (Note 8)	<u>1,134,186</u>	<u>1,294,438</u>
Total expenses	<u>1,134,186</u>	<u>1,294,438</u>
Net investment income	<u>\$ 90,453,982</u>	<u>\$ 201,043,246</u>

The accompanying notes are an integral part of these financial statements.

**STATE OF MONTANA BOARD OF INVESTMENTS
ALL OTHER FUNDS FINANCIAL STATEMENTS**

**STATEMENT OF CHANGES IN INVESTMENTS MANAGED
FOR THE FISCAL YEARS ENDED JUNE 30, 1996 AND 1995**

	<u>1996</u>	<u>1995</u>
Total investments managed, beginning of year	\$1,741,772,855	\$ 3,126,838,788
Net investment income	\$ 90,453,982	\$ 201,043,246
Income remitted to agencies	<u>(114,866,887)</u>	<u>(216,641,481)</u>
Increase (decrease) in interest receivable	(24,412,905)	(15,598,235)
Net bond swap gains/losses incurred during the year	0	2,518,556
Net amortization of deferred bond swap gains/losses	0	0
Accumulated deferred loss (Note 2)	<u>0</u>	<u>(3,178,396)</u>
Increase (decrease) in net unamortized gains/losses on bond swaps	0	(659,840)
Increase (decrease) in book value of investments due to net amortization of discounts and premiums	(1,296,341)	(604,818)
Investments purchased	4,377,350,088	5,339,326,859
Investments transferred to RFBP (Note 5)	0	(1,532,068,725)
Investments transferred to TFBP (Note 5)	(804,970,832)	0
Investments sold, matured and called	<u>(4,240,959,160)</u>	<u>(5,175,461,174)</u>
Increase (decrease) in book value of investments purchased	<u>(668,579,904)</u>	<u>(1,368,203,040)</u>
Net investments managed, end of year	<u>\$1,047,483,705</u>	<u>\$ 1,741,772,855</u>

The accompanying notes are an integral part of these financial statements.

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 1996 AND 1995**

1. HISTORY AND ORGANIZATION

The Board was created by an act of the Legislature to invest and manage the State of Montana's investment funds on a centralized basis per Section 17-6-201, MCA. The All Other Funds (AOF) investments and income are owned by various State of Montana agencies and managed on their behalf by the Board.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Investments

The AOF investments are purchased in accordance with the statutorily mandated "Prudent Expert Principle" and applicable investment restrictions of the participants. The AOF portfolio includes corporate asset-backed, other corporate, U.S. government mortgage-backed, U.S. government, yankee bonds, venture capital, leveraged buy-outs, other alternative equities, real estate, mortgages and loans. Corporate asset-backed securities represent debt securities collateralized by a pool of assets. U.S. government mortgage-backed securities reflect participation in a pool of residential mortgages. U.S. government securities include direct and indirect obligations of the U.S. Treasury. Yankee bonds are U.S. dollar denominated bonds issued by foreign corporations and governments and U.S. companies issuing debt in foreign markets. Venture capital represents private equity investments in early stage financing of rapidly growing companies with an innovative product or service. Leveraged buy-outs (LBO's) permit an investment group to acquire a company by leveraging debt, as a financing technique, to establish a significant ownership position on behalf of the

company's current management team. Other alternative equities include mortgage servicing rights.

The AOF portfolio includes structured financial instruments known as REMICs (Real Estate Mortgage Investment Conduits). REMICs are pass-through vehicles for multiclass mortgage-backed securities. Some AOF REMICs are principal-only strips (POs). Strip investments represent the separate purchase of the principal or interest cash flows of a mortgage security. POs receive cash flow from the principal payment component on underlying mortgage loans. These securities, purchased for portfolio diversification and a competitive rate of return, are identified and reported as U.S. government mortgage-backed securities in the investment risk and portfolio disclosures. (See Note 7 on Investment Risk Categories and Note 9 for the Year End Portfolio.)

AOF fixed income securities pay a fixed rate of interest until maturity while the variable-rate (floating-rate) securities pay a variable interest rate until maturity. The variable-rate securities float with LIBOR (London Interbank Offered Rate) and the 91 day treasury bill. The five variable-rate securities, with an amortized cost of \$9,273,432 on June 30, 1996, are identified and reported as corporate asset-backed and U.S. government direct/indirect securities in the investment risk and portfolio disclosures. (See Note 7 on Investment Risk Categories and Note 9 for the Year End Portfolio.)

Investments are presented in the Statement of Investments Managed at current value. Current values for publicly traded securities are determined primarily by reference to market prices supplied to the Board by the Board's custodial bank, State Street Bank. The real estate investments and residential and multi-family mortgages are valued based on a discounted cash flow. Amortized cost, parenthetically disclosed, represents the original cost, adjusted for premium and discount amortization where applicable. Premiums and discounts are amortized/accreted using the straight-line or interest method to the call, average life or maturity date of the securities.

Bond Swaps

Bond swaps involve trading one security for another security having the same par value for the purpose of enhancing portfolio content and/or yield. For pension funds, the Board deferred gains and losses resulting from bond swaps and amortized such gains and losses over the shorter of the remaining life of either the bonds sold or the replacement bonds purchased. The Board's bond swap policy was discontinued April 1, 1995, due to the creation of the Retirement Funds Bond Pool and scheduled accounting principles changes. The accumulated deferred loss of \$3,178,396 through March 31, 1995 was written off and recognized in fiscal year 1995. As shown in the accompanying financial statements, the accumulated net unamortized deferred loss on bond swaps was zero at June 30, 1996 and 1995.

Loans Receivable

Loans receivable, included in the Investments Managed at Current Value, represent commercial loans from the Coal Severance Tax Permanent Trust fund. As of June 30, 1996 and 1995, there were no uncollectible account balances.

3. SECURITIES LENDING

The Board has an agreement with the custodial bank whereby the bank lends to other entities securities managed by the Board. State Street Bank was appointed the Board's custodial bank

on December 1, 1993. During the period the securities are on loan, the Board receives a fee and the custodial bank must maintain collateral equal to 102 percent of the market value of the securities on loan. The Board retains all rights and risks of ownership during the loan period. Securities lending income was \$651,744 for fiscal year 1996 and \$1,375,897 for fiscal year 1995. On June 30, 1996 and 1995, respectively, \$302,085,610 and \$392,371,336 in securities were on loan to other entities.

4. COAL TAX LOAN AND MORTGAGE COMMITMENTS

The Board makes firm commitments to fund loans from the Coal Severance Tax Permanent Trust fund. These commitments have expiration dates and may be extended according to the Board's Administrative Rules. As of June 30, 1996 and 1995, the Board committed to purchase loans from Montana lenders totaling \$14,578,721 and \$9,986,930 respectively.

In fiscal year 1994, the Board began making firm commitments to fund mortgages from the Public Employees' and Teachers' retirement funds. As of June 30, 1996 and 1995, respectively, the Board committed to purchase mortgages from Montana lenders totaling \$21,361,377 and \$9,377,221.

5. FIXED INCOME AND VARIABLE-RATE SECURITIES TRANSFER

On April 1, 1995, \$1,532,068,725 in fixed income and variable-rate securities owned by the Public Employees', Municipal Police Officers', Game Wardens', Sheriffs', Judges', Highway Patrol Officers', Teachers', Volunteer Firefighters' and Firefighters' Unified retirement funds were transferred from the All Other Funds to the Retirement Funds Bond Pool (RFBP) without gain or loss. On October 1, 1995, \$804,970,832 in fixed income and variable-rate securities owned by the Coal Severance Tax Permanent Trust, Resource Indemnity Trust, Coal Tax Park Trust, Trust and Legacy, Coal Tax Cultural Trust, and Treasure State Endowment Trust funds were transferred from the All Other Funds to the Trust Funds Bond Pool (TFBP) without gain or loss.

The AOF interest receivable as of June 30, 1995 includes \$9,888,753 in pension fund receivables. In creating the RFBP, the pension funds did not receive cash compensation for the March 31, 1995 interest receivable on the securities transferred to the RFBP. The pension funds received cash payments on these receivables based on the security's pay date. The remaining pension funds' interest receivable of \$78,701 was paid in July 1996.

In creating the TFBP, the trust funds received cash compensation for the September 30, 1995 fixed and variable-rate interest receivables of \$16,343,972. The AOF interest receivable as of June 30, 1996 does not include any trust fund receivables.

Net investment income for fiscal year 1996 reflects fixed and variable-rate income earned for the trust funds for the three month period from July 1, 1995 through September 30, 1995. Net investment income for fiscal year 1995 includes fixed and variable-rate income earned for the pension funds for the nine month period from July 1, 1994 to March 31, 1995.

6. PENSION FUND REAL ESTATE INVESTMENT

In January 1996, the Board, on behalf of the Public Employees and Teachers' Retirement funds, purchased the 100 North Park Avenue Building in Helena, Montana as a real estate

investment. Acquired for a cost of \$4,864,326, the building carries a June 30, 1996 fair value of \$5,038,000. The three story building provides office space for nine tenants. Of the nine operating leases, four leases provide cancellation clauses, while the remaining leases are noncancellable. The schedule below details the minimum future rentals on the five noncancellable operating leases as of June 30, 1996:

<u>Year Ending June 30</u>	
1997	\$460,622
1998	461,761
1999	464,787
2000	484,114
2001	497,039
Later years	<u>2,596,525</u>
Total minimum future rentals	<u>\$4,964,848</u>

7. INVESTMENT RISK CATEGORIES

State of Montana investments are categorized on the following page to give an indication of the level of risk assumed at June 30, 1996 and June 30, 1995. Category 1 includes investments that are insured or registered, or securities that are held by the Board or its agent in the Board's name. Category 2 includes uninsured and unregistered investments, with securities held by the counterparts trust department or agent in the Board's name. Long-term investments are carried at amortized cost and short-term investments are carried at original cost.

<u>Investment Type</u>	<u>Risk as of June 30, 1996</u>		<u>Carrying Amount</u>	<u>Market Value</u>
	<u>Category 1</u>	<u>Category 2 *</u>		
Corporate Asset-Backed	\$ 71,581,466	\$ 0	\$ 71,581,466	\$ 71,228,247
Corporate Other	165,247,675	7,681,383	172,929,058	173,801,705
US Govt Mortgage-Backed	41,651,480	0	41,651,480	41,262,093
US Govt Direct/Indirect	100,202,172	288,940,828	389,143,000	386,979,468
Yankee Bonds	10,137,376	5,463,399	15,600,775	15,725,222
Venture Capital	16,869,996	0	16,869,996	19,069,486
Leveraged Buy-Outs	38,869,130	0	38,869,130	59,729,374
Other Alternative Equities	1,000,000	0	1,000,000	1,000,000
Real Estate	4,864,327	0	4,864,327	5,038,000
Mortgages and Loans	<u>255,396,937</u>	<u>0</u>	<u>255,396,937</u>	<u>250,342,476</u>
Total Long-Term	<u>705,820,559</u>	<u>302,085,610</u>	<u>1,007,906,169</u>	<u>1,024,176,071</u>

Short-Term Investments

<u>Investment Type</u>	<u>Category 1</u>	<u>Category 2</u>	<u>Carrying Amount</u>	<u>Market Value</u>
Money Market Savings	1,100,000	0	1,100,000	1,100,000
Repurchase Agreement	25,000,000	0	25,000,000	25,000,000
Total Short-Term	26,100,000	0	26,100,000	26,100,000
GRAND TOTAL	\$ 731,920,559	\$ 302,085,610	\$ 1,034,006,169	\$ 1,050,276,071

*At June 30, 1996, these securities with a market value of \$300,340,820 were loaned under a security lending agreement with the state's agent.

Risk as of June 30, 1995 Long-Term Investments

<u>Investment Type</u>	<u>Category 1</u>	<u>Category 2**</u>	<u>Carrying Amount</u>	<u>Market Value</u>
Corporate Asset-Backed	\$ 79,209,955	\$ 0	\$ 79,209,955	\$ 78,831,586
Corporate Other	590,599,088	40,332,297	630,931,385	656,291,860
US Govt Mortgage-Backed	82,751,657	0	82,751,657	83,393,550
US Govt Direct/Indirect	182,499,249	338,739,436	521,238,685	532,881,471
Yankee Bonds	55,111,682	13,249,197	68,360,879	74,524,507
State and Local Government	9,704,078	0	9,704,078	9,786,784
Venture Capital	16,563,491	50,406	16,613,897	17,808,945
Leveraged Buy-Outs	33,459,164	0	33,459,164	48,276,619
Other Alternative Equities	2,000,000	0	2,000,000	2,000,000
Mortgages and Loans	199,266,715	0	199,266,715	199,266,715
Total Long-Term	1,251,165,079	392,371,336	1,643,536,415	1,703,062,037

Short-Term Investments

<u>Investment Type</u>	<u>Category 1</u>	<u>Category 2</u>	<u>Carrying Amount</u>	<u>Market Value</u>
Repurchase Agreements	60,346,000	0	60,346,000	60,346,000
Total Short-Term	60,346,000	0	60,346,000	60,346,000
GRAND TOTAL	\$ 1,311,511,079	\$ 392,371,336	\$ 1,703,882,415	\$ 1,763,408,037

**At June 30, 1995, these securities with a market value of \$402,162,791 were loaned under a security lending agreement with the state's agent.

The fixed income and variable-rate instruments have credit risk as measured by major credit rating services. The Board of Investment's policy requires AOF fixed income and variable-rate investments, at the time of purchase, to be rated an investment grade as defined by Moody's and/or Standard & Poor's (S&P) rating services.

Market risk for the fixed income and variable-rate securities is caused by changes in the price or principal value of the security due to changes in interest rates.

As reported in the U.S. government mortgage-backed category, the AOF portfolio holds REMICs totaling \$6,257,802 at amortized cost as of June 30, 1996. As of June 30, 1995, the AOF portfolio held REMICs totaling \$33,824,106 at amortized cost. On October 1, 1995, REMICs with a June 30, 1995 amortized cost of \$23,228,330 were transferred to the Trust Funds Bond Pool. Two REMICs with a June 30, 1995 amortized cost of \$2,420,779 were sold in October 1995 and December 1995. These securities are based on separate or combined cash flows from principal and interest payments on underlying mortgages. The POs (principal only

strips) are more sensitive to prepayments by mortgagees resulting from interest rate changes than most other REMIC securities. For example, if interest rates decline and homeowners refinance mortgages, the underlying mortgages are prepaid. When underlying mortgages are prepaid, the interest cash flows are reduced while principal cash flows are increased. If homeowners pay on mortgages longer than anticipated, the cash flow effect would be the opposite.

Corporate asset-backed securities are based on cash flows from principal and interest payments on underlying car loans, credit card receivables, trade receivables, commercial mortgages and other assets. These securities, while sensitive to prepayments due to interest rate changes, have less credit risk than securities not backed by pledged assets. Market risk is also less because principal is paid back prior to the maturity date of the securities.

As of June 30, 1995, the El Paso Electric Company, presented a legal risk to the Board. This security, reported in the June 30, 1995 All Other Funds financial statements, was transferred to the Trust Funds Bond Pool (TFBP) on October 1, 1995. El Paso Electric Company declared bankruptcy in January 1992. Per the January 1992 bankruptcy order, the company paid its monthly interest payments. In 1995, the company began merger negotiations with another company. In June 1995, these negotiations ceased. Effective June 1995, the First Mortgage bond holders were notified the June monthly interest payment and subsequent interest payments would not be paid until further notice. On September 8, 1995, the Board received \$35,164 in interest for June 1 through August 31, 1995. At amortized cost, the TFBP owned \$1,402,000 of El Paso Electric Company, 9.95% First Mortgage Bonds, maturing May 1, 2004. The \$1,402,000 par, plus accrued interest and premium, was paid in full to the TFBP on February 26, 1996.

8. RESTATEMENT

As required by a change in accounting principle, the fiscal year 1995 investment income and administrative expenses have been restated to reflect alternative equity fees of \$491,580. In prior years, these fees were consistently netted against alternative equity income. The investment income and administrative expenses were previously reported as \$204,726,997 and \$802,858, respectively.

9. YEAR END PORTFOLIO

The June 30, 1996 All Other Funds portfolio is listed below.

All Other Funds Portfolio As Of June 30, 1996

<u>Security Name</u>	<u>Coupon</u>	<u>Maturity</u>	<u>Par</u>	<u>Amortized Cost</u>	<u>Market Value</u>
CIT GROUP SECURITIZATION CORP	4.70	06/15/2018	371,773	371,303	368,520
CHASE MANHATTAN GRANTOR TR	5.20	04/15/2002	1,731,525	1,731,015	1,703,924
E Q ASSET TR	5.00	10/15/2008	183,575	184,568	182,839
FIRST SECURITY GRANTOR TRUST	6.25	01/15/2001	5,589,188	5,594,421	5,596,174
FORD CR AUTO LN MASTER TR	6.88	01/15/99	1,000,000	997,371	1,005,000
FORD CR GRANTOR TR	5.90	10/15/2000	7,957,016	8,039,577	7,909,752
GMAC 1992 F GRANTOR TR	4.50	09/15/97	391,137	403,234	389,056
HYUNDAI AUTO GRANTOR	4.30	05/15/98	834,031	830,786	830,636

<u>Security Name</u>	<u>Coupon</u>	<u>Maturity</u>	<u>Par</u>	<u>Amortized Cost</u>	<u>Market Value</u>
KEYCORP AUTO GRANTOR TRUST	5.80	07/15/2000	9,719,347	9,692,867	9,676,777
MERRILL LYNCH MTG INVS INC	4.85	11/15/2017	1,531,302	1,529,479	1,526,035
MERRILL LYNCH MTG INVS INC	5.40	12/15/2013	5,000,000	4,914,471	4,864,050
MERRILL LYNCH MTG INVS INC	6.30	05/15/2014	6,137,691	6,127,392	6,125,477
NELLIE MAE INC ED LN REV	VAR	05/15/98	273,644	273,644	273,644
PREMIER AUTO TR	4.65	11/02/99	3,787,110	3,785,784	3,733,826
SEARS CREDIT ACCT MASTER TRI	5.90	11/15/98	625,000	623,955	625,388
SECURITIZED TRIPLE A REC	VAR	11/20/96	1,500,000	1,500,000	1,500,000
WORLD FINL NETWORK CR CARD TR	6.70	02/15/2004	10,000,000	9,981,600	10,001,600
WORLD OMNI AUTOMOBILE LEASE	6.05	11/25/2001	15,000,000	15,000,000	14,915,550
CORPORATE ASSET-BACKED			<u>71,632,340</u>	<u>71,581,466</u>	<u>71,228,247</u>
AMERICAN GEN CORP	7.70	10/15/99	5,000,000	4,964,593	5,116,900
AMERICAN STORES CO NEW	9.13	04/01/2002	5,000,000	5,336,212	5,441,800
BANKAMERICA CORP	7.63	06/15/2004	5,000,000	4,863,372	5,121,200
BURLINGTON NORTHN RR CO	6.94	01/02/2014	5,000,000	5,000,000	4,759,250
CHASE MANHATTAN CORP NEW	7.63	01/15/2003	5,000,000	4,916,128	5,127,700
CHRYSLER FINL CORP	5.38	10/15/98	2,000,000	1,988,982	1,951,200
DEAN WITTER DISCOVER + CO	6.88	03/01/2003	5,000,000	4,791,567	4,933,050
ENSERCH CORP	6.38	02/01/2004	5,000,000	4,670,688	4,660,350
FIRST BK NATL ASSN	8.35	11/01/2004	5,000,000	4,995,839	5,302,400
FIRST INTST BANCORP	9.00	11/15/2004	5,000,000	5,287,874	5,217,050
FIRST UN CORP	7.05	08/01/2005	5,000,000	4,945,248	4,886,000
FLEET FINL GROUP INC NEW	7.13	05/01/2000	5,000,000	4,971,501	5,041,100
FORD MTR CR CO	7.50	01/15/2003	5,000,000	5,071,106	5,068,750
FORD MTR CR CO	6.38	10/06/2000	1,000,000	1,017,001	981,800
GENERAL ELEC CAP CORP	6.20	03/15/97	750,000	749,024	751,740
HFS INC	5.88	12/15/98	3,000,000	2,995,267	2,926,050
HELLER FINL INC	6.45	02/15/97	1,932,450	1,927,492	1,933,996
KEYCORP NEW	7.50	06/15/2006	5,000,000	4,990,256	5,035,800
KEYCORP MTN BOOK ENTRY	7.45	04/05/2000	5,000,000	5,020,580	5,062,800
MONTANA PWR CO	7.60	11/07/97	5,000,000	5,000,000	5,081,150
NABISCO INC	6.70	06/15/2002	5,000,000	4,997,478	4,877,050
NATIONSBANK CORP	7.75	08/15/2004	5,000,000	4,867,002	5,139,850
PACIFIC GAS + ELEC CO	5.38	08/01/98	5,000,000	4,856,602	4,870,100
PACIFICORP HLDGS PPW	6.75	04/01/2001	5,000,000	4,979,615	4,941,500
PANHANDLE EASTN CORP	8.63	12/01/99	5,000,000	4,995,168	5,214,850
PHILADELPHIA ELEC CO	6.50	05/01/2003	2,000,000	1,992,730	1,921,640
QUAKER ST CORP	6.63	10/15/2005	5,000,000	4,973,687	4,723,800
RELIASTER FINL CORP	6.63	09/15/2003	2,000,000	1,922,612	1,880,660
ROYAL CARIBBEAN CRUISES LTD	7.13	09/18/2002	5,000,000	5,091,608	4,850,750
SEARS ROEBUCK + CO	9.25	04/15/98	5,000,000	5,108,522	5,231,450
SEARS ROEBUCK ACCEP CORP	6.50	06/15/2000	5,000,000	4,983,527	4,943,050
SHOPKO STORES INC	8.50	03/15/2002	5,000,000	5,312,078	5,110,350
SUN INC	8.13	11/01/99	5,000,000	4,997,565	5,161,250
SYSTEMS BUILDING CORP	8.00	07/01/97	218,729	218,729	223,948
TEXAS UTILS ELEC CO	5.88	04/01/98	5,000,000	4,837,108	4,952,250
TRAVELERS AETNA PPTY CAS CORP	6.75	04/15/2001	1,000,000	1,000,000	992,720
TRI CITY PPTY INVS CORP	13.50	03/01/99	377,395	377,395	408,911
TYCO LABS INC	6.38	01/15/2004	1,000,000	994,147	937,850
UNION OIL CO CA	7.20	05/15/2005	5,000,000	4,996,710	4,930,800
UNION PAC CORP	6.40	02/01/2006	5,000,000	4,923,143	4,655,000
WMX TECHNOLOGIES INC	8.25	11/15/99	1,000,000	999,490	1,043,500
WAL MART STORES INC	7.50	05/15/2004	5,000,000	5,005,843	5,109,900

<u>Security Name</u>	<u>Coupon</u>	<u>Maturity</u>	<u>Par</u>	<u>Amortized Cost</u>	<u>Market Value</u>
WAL MART STORES INC PASS THRU	8.45	07/01/2004	5,000,000	5,000,000	5,274,500
WESTERN INVT REAL ESTATE TR	7.88	02/15/2004	2,000,000	1,995,566	2,005,940
CORPORATE OTHER			<u>173,278,574</u>	<u>172,929,058</u>	<u>173,801,705</u>
FED HM LN PC G10173	6.00	01/01/2009	4,102,033	4,084,858	3,914,857
FED HM LN PC E00247	5.50	10/01/2008	2,840,437	2,821,783	2,646,918
FED NATL MTG ASSN GTD REMIC PO	0.00	05/25/2023	2,778,375	2,352,817	2,326,889
FEDERAL NATL MTG ASSN REMIC PO	0.00	10/25/2020	3,369,556	2,838,743	2,864,123
FEDERAL NATL MTG ASSN REMIC	8.95	05/25/2003	1,084,815	1,066,242	1,128,544
FNMA POOL 190985	7.50	08/01/2009	14,441,139	14,362,588	14,544,827
FNMA POOL 303590	7.00	10/01/2010	14,024,423	14,124,448	13,835,935
US GOVT MORTGAGE-BACKED			<u>42,640,779</u>	<u>41,651,480</u>	<u>41,262,093</u>
DYNACHEM	5.35	03/04/2001	8,125,000	8,125,000	7,934,063
EDISON CHQUEST OFFSHORE INC	5.66	02/15/2003	11,280,000	11,280,000	10,895,239
FEDERAL HOME LN BKS	VAR	09/29/97	1,500,000	1,501,001	1,501,875
FEDERAL HOME LN BKS	VAR	04/10/97	3,000,000	3,000,481	3,001,875
GUARANTEED EXPT TR PDVSA	6.28	06/15/2004	5,647,059	5,647,059	5,531,407
INGENIEROS CIVILES ASOCIADOS	4.79	05/15/98	1,220,446	1,220,446	1,207,082
INGENIEROS CIVILES ASOCIADOS	4.48	05/15/98	3,040,800	3,040,801	2,999,324
NORTH AMERICAN SHIP BUILDING	5.84	02/15/2006	6,386,000	6,386,000	6,128,900
STUDENT LN MARKETING ASSN	VAR	04/21/97	3,000,000	2,998,306	3,002,813
UNITED STATES TREAS BDS	8.75	11/15/2008	2,000,000	2,292,635	2,218,440
UNITED STATES TREAS BDS	9.13	05/15/2009	27,000,000	29,164,080	30,716,820
UNITED STATES TREAS NTS	8.25	07/15/98	1,500,000	1,585,367	1,559,295
UNITED STATES TREAS NTS	7.88	08/15/2001	600,000	620,753	635,622
UNITED STATES TREAS NTS	7.50	11/15/2001	2,400,000	2,614,824	2,505,384
UNITED STATES TREAS NTS	6.38	08/15/2002	3,000,000	3,159,093	2,976,090
UNITED STATES TREAS NTS	6.00	12/31/97	13,000,000	13,012,294	13,002,080
UNITED STATES TREAS NTS	6.25	02/15/2003	5,000,000	5,135,363	4,911,700
UNITED STATES TREAS NTS	5.13	06/30/98	25,000,000	24,681,619	24,535,250
UNITED STATES TREAS NTS	5.75	08/15/2003	10,000,000	9,686,572	9,523,400
UNITED STATES TREAS NTS	5.13	11/30/98	15,000,000	14,796,631	14,636,700
UNITED STATES TREAS NTS	7.25	08/15/2004	15,000,000	16,475,961	15,536,700
UNITED STATES TREAS NTS	7.50	10/31/99	15,000,000	15,600,494	15,489,900
UNITED STATES TREAS NTS	7.50	02/15/2005	20,000,000	20,884,249	21,040,600
UNITED STATES TREAS NTS	6.00	08/31/97	15,000,000	15,123,141	15,011,700
UNITED STATES TREAS NTS	5.63	11/30/2000	12,000,000	12,085,783	11,623,080
UNITED STATES TREAS NTS	6.38	03/31/2001	5,000,000	4,940,500	4,978,100
UNITED STATES TREAS NTS	8.88	02/15/99	5,000,000	5,220,889	5,311,700
UNITED STATES TREAS NTS	9.13	05/15/99	30,000,000	31,182,723	32,179,800
UNITED STATES TREAS NTS	8.00	08/15/99	5,000,000	5,018,767	5,228,100
UNITED STATES TREAS NTS	5.50	09/30/97	30,000,000	29,915,709	29,859,300
UNITED STATES TREAS NTS	5.13	03/31/98	45,000,000	44,999,411	44,296,650
UNITED STATES TREAS NTS	4.75	09/30/98	15,000,000	14,879,919	14,552,400
UNITED STATES TREAS NTS	5.13	12/31/98	15,000,000	14,958,577	14,622,600
UNITED STATES TREAS NTS	5.63	02/28/2001	5,000,000	4,925,189	4,832,050
UNITED STATES TREAS NTS	6.00	05/31/98	3,000,000	2,983,363	2,993,430
US GOVT DIRECT/INDIRECT			<u>382,699,305</u>	<u>389,143,000</u>	<u>386,979,468</u>
BRITISH COLUMBIA HYDRO + PWR	12.50	09/01/2013	200,000	206,240	230,372
GREAT LAKES PWR INC	8.90	12/01/99	5,000,000	4,993,335	5,201,750

<u>Security Name</u>	<u>Coupon</u>	<u>Maturity</u>	<u>Par</u>	<u>Amortized Cost</u>	<u>Market Value</u>
GRAND METROPOLITAN	7.00	06/15/99	5,000,000	4,937,801	5,037,500
NEWS AMER HLDGS INC	8.50	02/15/2005	5,000,000	5,463,399	5,255,600
YANKEE BONDS			<u>15,200,000</u>	<u>15,600,775</u>	<u>15,725,222</u>
ADVENT VI	NA		114,605	114,605	141,524
ADVENT V	NA		186,675	186,675	62,617
ALTA IV	NA		396,035	396,035	368,637
ALTA SUB DEBT PARTNERS III	NA		450,000	450,000	539,179
ALTA SUBORDINATED DEBT II	NA		302,178	302,178	321,278
AUSTIN VENTURES III	NA		372,027	372,027	464,389
BRINSON VENTURE CAPITAL FD III	NA		2,059,116	2,059,116	2,483,574
BRINSON VENTURE PARTNR FD III	NA		3,500,670	3,500,670	4,751,589
BRINSON TRUST	NA		500,000	500,000	500,203
CAPITAL PARTNERS HOLDINGS II A	NA		498,864	498,864	443,821
CROSSPOINT VENTURE PTNRS III	NA		377,853	377,853	317,552
EDISON VENTURE FD II LP	NA		384,397	384,397	483,515
GATEWAY VENTURE PARTNERS III	NA		381,966	381,966	202,538
HILL PARTNERSHIP III LP	NA		481,983	481,983	418,600
INTERMARK INC	NA		92	0	0
INTERWEST PARTNERS IV	NA		426,700	426,700	305,503
NORO MOSELEY PARTNERS II L P	NA		359,030	359,030	413,967
MATRIX PARTNERS III L P	NA		371,035	371,035	437,862
MEDA INC.	NA		125	0	66
MONOGENESIS CORP	NA		1	0	0
NEW ENTERPRISE ASSOC V	NA		345,434	345,434	421,868
TECH PARTNERS WEST FUND IV	NA		463,769	463,769	628,139
O DONNELL + MASUR L P	NA		455,451	455,451	560,502
SIERRA VENTURES II LP	NA		370,093	370,093	167,431
SOUTH ATLANTIC PARTNERS II L P	NA		342,551	342,551	326,495
JOSEPH LITTLEJOHN + LEVY FUND	NA		407,250	407,250	682,599
SPROUT CAPITAL VI	NA		408,350	408,350	433,227
SUMMIT VENTURE II	NA		205,138	205,138	76,712
TRITON GROUP LTD NEW	NA		1	0	1
TRITON GROUP LTD NEW	NA		2	0	0
VENTURE PARTNERSHIP ACQUIST	NA		1,149,874	1,149,874	1,516,717
WCAS CAPITAL PARTNERS II	NA		428,158	428,158	456,209
WELSH CARSON ANDERSON V	NA		297,183	297,184	350,639
WHITNEY 1990 EQUITY FUND LP	NA		478,220	478,220	454,435
WILLIAM BLAIR PARTNERS III LP	NA		355,390	355,390	338,101
VENTURE CAPITAL			<u>16,870,216</u>	<u>16,869,996</u>	<u>19,069,486</u>
KKR 1993	NA		15,700,202	15,700,202	17,555,275
KKR 1986 1987	NA		23,168,928	23,168,928	42,174,098
LEVERAGED BUY-OUT			<u>38,869,130</u>	<u>38,869,130</u>	<u>59,729,374</u>
AMERICA FIRST MTG SERVICING CO	NA		1,000,000	1,000,000	1,000,000
OTHER ALTERNATIVE EQUITIES			<u>1,000,000</u>	<u>1,000,000</u>	<u>1,000,000</u>
REAL ESTATE INVESTMENT	NA		4,864,327	4,864,327	5,038,000
REAL ESTATE			<u>4,864,327</u>	<u>4,864,327</u>	<u>5,038,000</u>

<u>Security Name</u>	<u>Coupon</u>	<u>Maturity</u>	<u>Par</u>	<u>Amortized Cost</u>	<u>Market Value</u>
RESIDENTIAL MORTGAGES	NA		144,058,609	144,058,609	139,276,771
MULTI-FAMILY MORTGAGES	NA		7,051,108	7,051,108	6,778,485
COMMERCIAL IN-STATE LOANS	NA		104,287,221	104,287,221	104,287,221
MORTGAGES AND LOANS			<u>255,396,937</u>	<u>255,396,937</u>	<u>250,342,476</u>
BUSINESS MONEY MKT SVGS	2.90		1,100,000	1,100,000	1,100,000
MONEY MARKET SAVINGS			<u>1,100,000</u>	<u>1,100,000</u>	<u>1,100,000</u>
FIRST BANK	5.15	07/17/96	5,000,000	5,000,000	5,000,000
FIRST BANK	5.25	07/01/96	10,000,000	10,000,000	10,000,000
STATE STREET	5.18	07/17/96	10,000,000	10,000,000	10,000,000
REPURCHASE AGREEMENTS			<u>25,000,000</u>	<u>25,000,000</u>	<u>25,000,000</u>
TOTAL ALL OTHER FUNDS			<u>\$1,028,551,608</u>	<u>\$1,034,006,169</u>	<u>1,050,276,071</u>

Independent Auditor's Report & Enterprise Fund Financial Statements

MONTANA LEGISLATIVE BRANCH

Legislative Auditor
Scott A. Seacat

Legal Counsel:
John Northey



Deputy Legislative Auditors:
Mary Bryson
Operations and EDP Audit
James Gillett
Financial-Compliance Audit
Jim Pellegrini
Performance Audit

LEGISLATIVE AUDIT DIVISION

INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the accompanying Balance Sheet of the Enterprise Fund of the state of Montana Board of Investments as of June 30, 1996 and 1995, and the related Statement of Revenues, Expenses and Changes in Retained Earnings and Statement of Cash Flows for the two fiscal years then ended. These financial statements are the responsibility of the Board of Investments' management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in note 1, the financial statements present only the Enterprise Fund and are not intended to present fairly the financial position and results of operations of the state of Montana in conformity with generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the state of Montana Board of Investments' Enterprise Fund as of June 30, 1996 and 1995, and the results of its operations and cash flows of its Enterprise Fund for the fiscal years then ended in conformity with generally accepted accounting principles.

Respectfully submitted,

A handwritten signature in cursive script that reads "James Gillett".

James Gillett, CPA
Deputy Legislative Auditor

October 4, 1996

STATE OF MONTANA BOARD OF INVESTMENTS ENTERPRISE FUND
BALANCE SHEET AS OF JUNE 30, 1996 AND 1995

Assets

	<u>1996</u>	<u>1995</u>
<i>Current:</i>		
Cash and cash equivalents (Note 1)	\$ 5,039,097	\$ 1,705,697
Interest receivable	917,849	1,062,842
Short-term investments (Note 2)	3,752,430	3,378,311
Prepaid expenses	110	146
Due from other funds	<u>4,625</u>	<u>163</u>
<i>Total current</i>	<u>9,714,111</u>	<u>6,147,159</u>
<i>Long-term:</i>		
Notes/loans receivable (Note 1)	27,520,833	29,110,379
Investments (Note 2)	5,744,252	6,373,502
Capitalized cost of issue	1,007,385	1,082,534
Equipment	41,251	35,690
Accumulated depreciation	<u>(19,801)</u>	<u>(18,562)</u>
<i>Total long-term</i>	<u>34,293,920</u>	<u>36,583,543</u>
<i>Total assets</i>	<u>\$44,008,031</u>	<u>\$42,730,702</u>

Liabilities

<i>Current:</i>		
Advances	\$ 33,237	\$ 67,292
Accounts payable	14,338	303
Due to other funds	11,367	10,365
Accrued expenses	968	0
Accrued interest payable	659,615	854,703
Arbitrage rebate tax payable	0	30,245
Current bonds/notes payable (Note 3)	<u>29,393,995</u>	<u>22,592,119</u>
<i>Total current</i>	<u>30,113,520</u>	<u>23,555,027</u>
<i>Long-term:</i>		
Bonds/Notes payable (Note 3)	11,198,899	16,575,759
Compensated absences	12,218	12,308
Deferred cost of issue recovery	267,173	358,047
Arbitrage rebate tax payable	<u>261,233</u>	<u>339,487</u>
<i>Total long-term</i>	<u>11,739,523</u>	<u>17,285,601</u>
<i>Total liabilities</i>	<u>41,853,043</u>	<u>40,840,628</u>
<i>Retained Earnings</i>	<u>2,154,988</u>	<u>1,890,074</u>
<i>Total liabilities and retained earnings</i>	<u>\$44,008,031</u>	<u>\$42,730,702</u>

The accompanying notes are an integral part of these financial statements.

STATE OF MONTANA BOARD OF INVESTMENTS ENTERPRISE FUND

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN RETAINED EARNINGS FOR THE FISCAL YEARS ENDED JUNE 30, 1996 AND 1995

<u>Revenue</u>	<u>1996</u>	<u>1995</u>
Bond issue fee	\$ 24,375	\$ 24,375
Investment income (Note 6)	845,952	673,796
Operations income (Note 6)	2,416,080	2,557,363
Reimbursements	<u>35,456</u>	<u>37,753</u>
Total revenue	<u>3,321,863</u>	<u>3,293,287</u>
<u>Expenses</u>		
Personal services	133,227	116,747
Contracted services	14,202	12,346
Supplies and materials	2,880	2,212
Communications	4,640	4,648
Travel	9,109	2,975
Rent	18,672	19,522
Repair and maintenance	3	253
Indirect and other costs	12,141	11,709
Debt service		
Interest	2,286,037	2,496,743
Trustee fees	26,362	25,556
Bond issuance cost amortization	288,218	298,799
Other debt service expense (Note 6)	137,682	64,025
Depreciation	3,893	4,177
Arbitrage rebate tax	122,460	75,159
Loss on equipment disposal	<u>281</u>	<u>117</u>
Total expenses	<u>3,059,807</u>	<u>3,134,988</u>
Net gain	262,056	158,299
Retained earnings, July 1	1,890,074	1,902,095
Prior period adjustment (Note 5)	<u>2,858</u>	<u>(170,320)</u>
Adjusted retained earnings, July 1	<u>1,892,932</u>	<u>1,731,775</u>
Retained earnings, June 30	<u>\$2,154,988</u>	<u>\$1,890,074</u>

The accompanying notes are an integral part of these financial statements.

STATE OF MONTANA BOARD OF INVESTMENTS ENTERPRISE FUND
STATEMENT OF CASH FLOWS FOR THE YEARS ENDED JUNE 30, 1996 AND 1995
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS

	<u>1996</u>	<u>1995</u>
Cash flows from operating activities:		
Receipts for sales and services (Note 6)	\$ 2,348,543	\$ 2,443,477
Collections for principal and interest on loans	9,177,976	6,414,659
Cash payments for loans	(7,444,236)	(6,317,892)
Payments to suppliers for goods and services	(58,221)	(53,953)
Payments to employees	<u>(133,256)</u>	<u>(112,401)</u>
Net cash provided by operating activities (Note 6)	<u>3,890,806</u>	<u>2,373,890</u>
Cash flows from non-capital financing activities:		
Payment of principal and interest on bonds and notes (Note 6)	(9,677,241)	(8,781,673)
Proceeds from issuance of bonds and notes (Note 6)	8,378,269	451,686
Payment of bond issuance costs	<u>(120,861)</u>	<u>(11,836)</u>
Net cash used for non-capital financing activities (Note 6)	<u>(1,419,833)</u>	<u>(8,341,823)</u>
Cash flows from capital and related financing activities:		
Acquisition of fixed assets	<u>(8,496)</u>	<u>0</u>
Net cash used for capital and related financing activities	<u>(8,496)</u>	<u>0</u>
Cash flows from investing activities:		
Purchase of investments	(7,355,624)	(6,658,026)
Proceeds from sales or maturities of investments	7,809,979	9,557,941
Interest on investments (Note 6)	647,527	328,173
Payments for arbitrage rebate tax (Note 6)	<u>(230,959)</u>	<u>(2)</u>
Net cash provided by investing activities (Note 6)	<u>870,923</u>	<u>3,228,086</u>
Net increase (decrease) in cash and cash equivalents	3,333,400	(2,739,847)
Cash and cash equivalents, July 1	<u>1,705,697</u>	<u>4,445,544</u>
Cash and cash equivalents, June 30	<u>5,039,097</u>	<u>1,705,697</u>
Reconciliation of net gain to net cash provided by operating activities:		
Net gain	262,056	158,299
Adjustments to reconcile net gain to net cash provided by operating		
Depreciation	3,893	4,177
Interest on investments (Note 6)	(845,952)	(673,796)
Interest expense (Note 6)	2,738,299	2,885,123
Arbitrage rebate tax expense (Note 6)	122,460	75,159
Loss on disposal of fixed assets	281	117
Prior year adjustment related to operations	2,858	(407)
Change in assets and liabilities:		
Increase/decrease in due from other funds	(4,462)	(163)
Increase/decrease in long-term loans/notes receivable	1,589,546	134,509
Increase/decrease in accounts receivable	144,194	(37,742)
Increase/decrease in other assets	36	298
Increase/decrease in accounts payable	646	(301)
Increase/decrease in other payables	968	0
Increase/decrease in due to other funds	1,002	3,470
Increase/decrease in compensated absences payable	(90)	1,161
Increase/decrease in deferred revenue (Note 6)	(90,874)	(71,852)
Increase/decrease in advances (Note 6)	<u>(34,055)</u>	<u>(104,162)</u>
Total adjustments	<u>3,628,750</u>	<u>2,215,591</u>
Net cash provided by operating activities (Note 6)	<u>\$ 3,890,806</u>	<u>\$ 2,373,890</u>

The accompanying notes are an integral part of these financial statements.

STATE OF MONTANA BOARD OF INVESTMENTS ENTERPRISE FUND

NOTES TO FINANCIAL STATEMENTS FOR THE FISCAL YEARS ENDED JUNE 30, 1996 AND JUNE 30, 1995

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a. Basis of Accounting

The Board uses the accrual basis of accounting for the Enterprise Fund. Under the accrual basis of accounting, expenses are recorded when incurred and revenues are recorded when earned. The financial statements are prepared from the Statewide Budgeting and Accounting System (SBAS) and information contained in the bond trustee statements. The statements include the financial activity administered by the Board in the Enterprise Fund.

b. Presentation of Programs

The Board uses the Enterprise Fund to account for its programs created under the Economic Development Bond Act and the Municipal Finance Consolidation Act.

Economic Development Bond Act programs include:

- The Industrial Development Bond Program (IDB), a business finance program, provides funds to purchase economic development loans.
- The Conservation Reserve Enhancement Program (CRP), created in 1990 by issuing Economic Development Bonds, allows farmers to receive a lump sum payment by assigning their federal CRP contract to the Board. The farmers under contract must comply with seeding and other requirements.

Municipal Finance Consolidation Act programs include:

- The Montana Cash Anticipation Financing (MCAF) program provides tax anticipation financing to local governments.
- The Intermediate Term Capital Pool (INTERCAP) program provides funds to local governments to finance capital expenditures for up to five years.
- The Irrigation District Pooled Loan Program provided funds for the Board to purchase the refunding bonds from participating irrigation districts for the purpose of prepaying the U.S. Department of Interior, Bureau of Reclamation Projects Loans.
- The School District Pooled Refunding Program provides funds for the Board to purchase the general obligation refunding bonds of participating Montana School Districts.

c. Fixed Asset Depreciation

The equipment fixed assets recorded in the Enterprise Fund are depreciated on a straight-line basis, with salvage value, in accordance with state policy.

d. Receivables

The Enterprise Fund notes/loan receivables of \$27,520,833 as of June 30, 1996, and \$29,110,379 as of June 30, 1995, represent loans made to Montana businesses and local governments. Historically, there have been no uncollectible account balances.

e. Cash Equivalents

For purposes of the Statement of Cash Flows, the Enterprise Fund considers all highly liquid investments with an original maturity of three months or less when purchased to be cash equivalents. Cash and cash equivalents, as identified in the Balance Sheet, are as follows:

	<u>June 30, 1996</u>	<u>June 30, 1995</u>
Cash in treasury	\$ 7,933	\$ 16,746
Cash with fiscal agent	31	30
Short Term Investment Pool (STIP)	180,186	280,596
First American treasury obligation class D corporate trust fund	<u>4,850,947</u>	<u>1,408,325</u>
Cash and cash equivalents	\$ <u>5,039,097</u>	\$ <u>1,705,697</u>

2. INVESTMENTS

The deposits and investments in the Enterprise Fund are restricted by the bond trust indentures to the following: government and agency obligations, certificates of deposits, repurchase agreements, and investment agreements. Deposits and investments must be made with Montana banks or in the Short Term Investment Pool (STIP) administered by the Board. The deposits and investments are combined on the Board's financial statements.

Investments are presented in the Balance Sheet at amortized cost. Amortized cost or carrying value represents the original cost, adjusted for premium and discount amortization where applicable. Premiums and discounts are amortized/accreted using the straight line method to the maturity date of the securities. Investment market values for publicly traded securities are determined primarily by reference to market prices supplied to the Board's custodial bank or trustee.

The Board's investments in the Enterprise Fund are classified below as to credit risk by Category 1, which includes insured or registered, or securities held by the Board or its agent in the Board's name.

Risk As Of June 30, 1996
Long-Term Investments

<u>Investment Type</u>	<u>Category 1</u>	<u>Carrying Value</u>	<u>Market Value</u>
Government Securities	<u>\$5,744,252</u>	<u>\$5,744,252</u>	<u>\$5,815,933</u>
Total long-term investments	<u>\$5,744,252</u>	<u>\$5,744,252</u>	<u>\$5,815,933</u>

Short-Term Investments

Government Securities	<u>\$3,752,430</u>	<u>\$3,752,430</u>	<u>\$3,759,839</u>
Total short-term investments	<u>\$3,752,430</u>	<u>\$3,752,430</u>	<u>\$3,759,839</u>

Risk As Of June 30, 1995
Long-Term Investments

<u>Investment Type</u>	<u>Category 1</u>	<u>Carrying Value</u>	<u>Market Value</u>
Government Securities	<u>\$6,373,502</u>	<u>\$6,373,502</u>	<u>\$6,671,287</u>
Total long-term investments	<u>\$6,373,502</u>	<u>\$6,373,502</u>	<u>\$6,671,287</u>

Short-Term Investments

Government Securities	<u>\$3,378,311</u>	<u>\$3,378,311</u>	<u>\$3,385,717</u>
Total short-term investments	<u>\$3,378,311</u>	<u>\$3,378,311</u>	<u>\$3,385,717</u>

There were no derivative transactions during the fiscal year for investments held by the trustee.

3. BONDS/NOTES PAYABLE

Long-Term Bonds/Notes Payable

Economic Development Bonds (EDB), Municipal Finance Consolidation Act Bonds (MFCAB), and Industrial Development Revenue Bonds (IDB)

These bonds are issued under the Economic Development Bond Act, and the Municipal Finance Consolidation Act, for the purpose of assisting Montana's small businesses and local governments in obtaining low cost financing. Outstanding obligations are listed on the next page (in thousands):

<u>Program</u>	<u>Series</u>	<u>Amount Issued</u>	<u>Interest Range %</u>	<u>←Principal Payments→</u>			<u>Balance June 30,1996</u>
				<u>FY 97</u>	<u>@ Maturity</u>		
Industrial Development Revenue Bonds (Pooled Loan Program) (1)	1984A	\$ 70	7.00-10.75	\$ 5	\$ 15	(2000)	\$ 30
Industrial Development Revenue Bonds (Pooled Loan Program) (1)	1985A,G,H	790	6.75-10.10	35	95	(2007)	600
Municipal Finance Consolidation Act Bonds (Irrigation Program) (2)	1988	4,976	6.60-7.75	495	130	(2014)	4,497
Economic Development Bond Act Bonds (Conservation Reserve Enhancement Program) (3)	1991A-B	7,380	10.00-11.20	1,225	285	(2000)	2,825
Municipal Finance Consolidation Act Bonds (School District Pooled Refunding Program) (4)	1991	<u>6,234</u>	4.75-6.50	<u>467</u>	294	(2005)	<u>3,326</u>
Total Bonds Payable		\$ 19,450		\$ 2,227			\$ 11,278
Conservation Reserve Enhancement Program (CRP Notes) (3)		<u>3,255</u>	7.50-9.92	<u>1,107</u>	274	(2001)	<u>3,255</u>
Total Bonds/Notes Payable		<u>\$ 22,705</u>		<u>\$ 3,334</u>			\$ 14,533
Less Current Portion (FY97 Principal Payments)							<u>(3,334)</u>
Total Long-Term Bonds/Notes Payable							\$ <u>11,199</u>

<u>Program</u>	<u>Series</u>	<u>Amount Issued</u>	<u>Interest Range %</u>	<u>←Principal Payments→</u>			<u>Balance June 30,1995</u>
				<u>FY 96</u>	<u>@ Maturity</u>		
Industrial Development Revenue Bonds (Pooled Loan Program) (1)	1984A,F,G	\$ 1,495	7.00-10.75	\$ 55	\$ 340	(2006)	\$ 1,180
Industrial Development Revenue Bonds (Pooled Loan Program) (1)	1985A,C-I,K	3,160	6.75-10.10	110	395	(2007)	2,520
Municipal Finance Consolidation Act Bonds (Irrigation Program) (2)	1988	4,976	6.60-7.75	455	130	(2014)	4,804
Economic Development Bond Act Bonds (Conservation Reserve Enhancement Program) (3)	1991A-B	7,380	10.00-11.20	1,160	285	(2000)	3,985
Municipal Finance Consolidation Act Bonds (School District Pooled Refunding Program) (4)	1991	<u>6,234</u>	4.75-6.50	<u>466</u>	294	(2005)	<u>3,792</u>
Total Bonds Payable		\$ 23,245		\$ 2,246			\$ 16,281
Conservation Reserve Enhancement Program (CRP Notes) (3)		<u>3,307</u>	9.00-9.92	<u>766</u>	455	(1999)	<u>3,307</u>
Total Bonds/Notes Payable		<u>\$ 26,552</u>		<u>\$ 3,012</u>			\$ <u>19,588</u>
Less Current Portion (FY96 Principal Payments)							<u>(3,012)</u>
Total Long-Term Bonds/Notes Payable							\$ <u>16,576</u>

(1) The bonds, which may not aggregate more than \$75 million, are limited obligations of the Board payable solely from and secured by certain revenues and assets pledged pursuant to an Indenture of Trust. The bonds do not constitute a debt, liability or legal obligation of the State of Montana. However, if the balance in the "Capital Reserve Account A" falls below the Indenture requirement, the Governor is required to request the appropriate funds to correct any such deficiency. Principal payments (accrued interest to be added) are due each March 15. Series 1985 J (\$665,000) and Series 1985 B (\$775,000) were recalled on March 15 and December 15, 1988, respectively, without a gain or loss on extinguishment. Series 1985 L (\$325,000) were recalled in March 1992, without a gain or loss on extinguishment. Series 1984 B (\$510,000), Series 1984 C (\$255,000), Series 1984 D (\$970,000) and Series 1984 E (\$420,000) were retired March 15, 1995, through the exercise of optional redemption provisions resulting from loan prepayments. Loss from early extinguishment totaled \$40,877. On March 15, 1996, Series 1984 F (\$225,000), Series 1984

G (\$1,200,000), Series 1985 C (\$190,000), Series 1985 D (\$285,000), Series 1985 E (\$790,000), Series 1985 F (\$345,000), Series 1985 I (\$90,000) and Series 1985 K (\$670,000) were retired through the exercise of optional redemption provisions resulting from loan prepayments. Loss from early extinguishment totaled \$1,608 for Series 1984 and \$9,313 for Series 1985.

(2) The Board issued these bonds to provide funds to purchase the Refunding Bonds of participating Irrigation Districts for the purpose of prepaying the U.S. Department of Interior, Bureau of Reclamation Projects Loans. The Irrigations Bonds and the interest thereon are payable solely from the collection of a special tax or assessment which is a lien against real property in the Irrigation District. While the Irrigation Bonds are not obligations of the State of Montana, the bonds are limited obligations of the Board due to an irrevocable pledge to lend money for deposit by the Trustee of the Irrigation District Pooled Loan Program Reserve Account E in an amount equal to any deficiencies therein on any payment date. The Indenture does not permit the issuance of additional bonds.

(3) The Board issued these bonds and notes to provide funds to purchase the Board's outstanding Bond Anticipation Notes (BAN's), and make loans to participating farmers and ranchers under its Conservation Reserve Enhancement Program. The Series 1991 Bonds are not in any way a debt or liability of the State of Montana, and neither the full faith and credit, nor the taxing power of the State of Montana is pledged to the payment of the principal of or interest on the Bonds. However, the 1991 Bonds are limited obligations of the Board. The BAN's which matured on November 15, 1992, were reissued to correspond with maturities per the underlying loans. On November 15, 1994, eleven BAN's were reissued to comply with statutory requirements limiting the maturity of notes to five years from issuance date.

(4) The Board issued these bonds to provide funds to purchase the general obligation refunding bonds of participating Montana School Districts. The School District Refunding Bonds and the interest thereon are payable from real property taxes levied within the school district. The 1991 Bonds are limited obligations of the Board, and are not a debt or liability of the State of Montana, and neither the faith and credit nor the taxing power of the state is pledged to the payment of principal of or interest on the bonds.

Fiscal year 1997 debt service requirements (principal & interest) are listed below (in thousands):

<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002+</u>	<u>Total</u>
\$4,416	\$3,640	\$2,638	\$2,036	\$1,567	\$5,434	\$19,731

Fiscal year 1996 debt service requirements (principal & interest) are listed below (in thousands):

<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001+</u>	<u>Total</u>
\$4,586	\$4,527	\$3,861	\$2,936	\$2,634	\$9,945	\$28,489

Fiscal year 1996 debt service requirements for the years 2000, 2001+ and Total were previously reported as \$3,022, \$9,763 and \$28,695, respectively. The debt service requirements (principal and interest) were restated due to the correction of an error.

Current Bonds/Notes Payable

The Enterprise Fund is authorized to issue Intermediate Term Capital (INTERCAP) bonds under the Municipal Finance Consolidation Act. These bonds may not aggregate more than \$50 million. The INTERCAP bonds provide funds for the Board to make loans to eligible local government units. The bonds are not a debt or liability of the State of Montana. The bonds are limited obligations of the Board payable solely from: a) repayments of principal and interest on loans made by the Board to participating local government units; b) investment income under the indenture; and c) an irrevocable pledge by the Board. The Board has no taxing power. These bonds may be redeemed, at the bondholder's option, any March 1, prior to maturity. The Board did not enter into an arms-length financing agreement to convert the bonds "put", but not resold into some other form of long-term obligation. Accordingly, these bonds, considered demand bonds, are recorded as current liabilities of the Enterprise Fund. The INTERCAP obligations at June 30, 1996 and June 30, 1995, are listed below (in thousands):

<u>Series</u>	<u>Amount Issued</u>	<u>Interest Range</u>	<u>Maturity</u>	<u>Balance June 30, 1996</u>	<u>Balance June 30, 1995</u>
1988	5,000	Variable	1996	\$ 0	\$ 910
1991	5,000	Variable	2001	4,875	4,890
1992	6,500	Variable	2005	6,365	6,365
1994	7,500	Variable	2009	7,355	7,415
1995	<u>7,500</u>	Variable	2010	<u>7,465</u>	<u>0</u>
Total INTERCAP Debt	<u>\$31,500</u>			<u>26,060</u>	<u>19,580</u>
Current Portion of Long-Term Bonds/Notes Payable				<u>3,334</u>	<u>3,012</u>
Total Current Bonds/Notes Payable				<u>\$29,394</u>	<u>\$22,592</u>

4. OTHER DEBT

Conduit Debt

In this program, the Board is authorized to issue stand-alone industrial revenue bonds as conduit (no commitment) debt. Assets and revenues of the borrower are pledged to repay the bonds. Because the state has no obligation for this debt, these bond issues are not reflected on the Board's financial statements. Bonds issued by the Board as conduit (no-commitment) debt are listed below (in thousands):

<u>Project</u>	<u>Issue Date</u>	<u>Maturity Date</u>	<u>Amount Issued</u>	<u>Balance June 30, 1996</u>	<u>Balance June 30, 1995</u>
MT Cenex (Farmers Union)	August 1985	09/01/2010	\$ 3,925	\$ 3,925	\$ 3,925
Bozeman Holiday Inn	October 1987	12/01/2007	4,485	3,685	3,815
Colstrip	October 1989	12/30/2015	60,800	60,800	60,800
Yellowstone Energy (BGI)	July 1993	12/31/2019	<u>118,345</u>	<u>118,345</u>	<u>118,345</u>
Total conduit debt			\$ 187,555	\$ 186,755	\$ 186,885

Payroll Tax Bonds

On July 15, 1991, the Board issued \$142,095,000 in Payroll Tax Bonds (Workers' Compensation Program Series 1991). The Series 1991 Bonds are limited obligations of the State of Montana, payable solely from and secured by certain payroll tax revenues. The bonds are not general obligations of the Board, the State of Montana, the Montana State Compensation Insurance Fund, or any political subdivision of the state, and neither the faith and credit nor the general taxing power of the state is pledged to the payment of the principal or interest on the bonds.

Because the bonds are payable solely from and secured by certain payroll tax revenues and are not general obligations of the Board, the Payroll Tax Bonds are not recorded in the Board's financial statements. The Payroll Tax Bonds and related debt service fund activity are reported on the Montana State Compensation Insurance Fund financial statements.

These bonds were issued to: a) provide funding for the Montana State Compensation Insurance Fund's liability, with respect to the cost of administering and paying claims for injuries resulting from accidents that occurred prior to July 1, 1990, that are subject to the Montana Worker's Compensation Act and the Occupational Disease Act of Montana; b) fund a debt service reserve; and c) pay the cost of issuance for the Payroll Tax Bonds.

Early Bond Redemptions

Using cash determined by the Montana State Compensation Insurance Fund to be in excess of the amount needed to pay claims occurring on or before July 1, 1990, the Board provided for two early redemptions of \$20,880,000 and \$13,075,000 in Payroll Tax Bonds (Workers' Compensation Program Series 1991). On July 24, 1995 and March 26, 1996, the Board deposited \$21,528,449 and \$13,521,916, respectively, with an escrow agent and invested in federal securities to provide for the future debt service payments until the bonds mature through June 1, 2020. Both transactions met the requirements of a legal defeasance. The \$20,880,000 and \$13,075,000 in Series 1991 Bonds maturing through June 1, 2020 were removed from the Montana State Compensation Insurance Fund accounting records in July 1995 and March 1996. The fiscal year 1996 loss related to these early bond redemptions totaled \$1,709,046. This amount relates to the write off of original bond discount and cost of issuance and bond premium paid for early redemption.

Variable-Rate Payroll Tax Bonds

On October 27, 1993, the Board issued \$32,500,000 in Variable-Rate Payroll Tax Bonds (Workers' Compensation Program Series 1993). The Series 1993 Bonds are limited obligations of the State of Montana, payable solely from and secured by certain payroll tax revenues. The bonds are not general obligations of the Board, the State of Montana, the Montana State Compensation Insurance Fund, or any political subdivision of the state, and neither the faith and credit nor the general taxing power of the state is pledged to the payment of the principal of or interest on the bonds. The bonds are being issued with a pledge of and lien on the pledged amounts on a parity with that of the \$142,095,000 Payroll Tax Bonds (Workers' Compensation Program Series 1991).

Because the bonds are payable solely from and secured by certain payroll tax revenues and are not general obligations of the Board, the Variable-Rate Payroll Tax Bonds are not recorded in the Board's financial statements. The Variable-Rate Payroll Tax Bonds and related debt service fund activity are reported on the Montana State Compensation Insurance Fund financial statements.

5. PRIOR PERIOD ADJUSTMENT

The fiscal year 1996 prior period adjustment of \$2,858 reflects a refund of \$736 and a \$2,122 correction to Health Facility Authority reimbursements. The fiscal year 1995 prior period adjustment of \$(170,320) reflects: a) adjustments of \$(163,835) to investment earnings for corrections of notes receivable; b) a \$(3,078) correction for software capitalization; c) a \$(3,000) correction for cost issuance; and d) \$(407) in miscellaneous adjustments.

6. RESTATEMENT

In the Statement of Revenues, Expenses, and Changes in Retained Earnings for the fiscal year ended June 30, 1995, the Cost of Issue Recovery was renamed as Operations Income. Cost of Issue Recovery income of \$67,160 was restated as Operations Income of \$2,557,363, while Investment Income for fiscal year 1995 has been restated as \$673,796. Investment Earnings of \$3,062,375, as previously recorded, included both operations and investment income. Other debt service expense of \$(37,599), as previously reported, was restated as \$64,025 to correct the recording of \$101,624 in origination fees. These origination fees, as restated, are included in Operations Income. The fiscal year 1995 net gain of \$158,299 remains unchanged.

In the Statement of Cash Flows for the Year Ended June 30, 1995, the Receipts for Sales and Services were restated from \$62,128 to \$2,443,477 to reflect the operations income reclassification. This change resulted in the Net Cash (Used for) Provided by Operating Activities being restated from \$(7,461) to \$2,373,890. The Payment of Principal and Interest on Bonds and Notes was restated from \$(8,880,044) to \$(8,781,673) to reflect the correction of origination fees and the cash flow reclassification of cost of issuance amortization. Proceeds from Issuance of Bonds and Notes were restated from \$646,989 to \$451,686 due to the cost of issuance amortization reclassification and the restatement of cost of recovery activity. The Net Cash Used for Non-Capital Financing Activities was previously reported as \$(8,244,891). Due to the reclassification of operations and investment income, Interest on Investments has

been restated from \$2,612,590 to \$328,173. The Net Cash Provided by Investing Activities was previously reported as \$5,512,505. The Net Decrease in Cash and Cash Equivalents as of June 30, 1995 of \$(2,739,847) remains unchanged.

In the Reconciliation of Net Gain to Net Cash Provided by Operating Activities, the Interest on Investments and Interest Expense were previously reported as \$3,062,375 and \$2,783,499, respectively. Due to an accounting policy change, Payments for Arbitrage Rebate Tax of \$(2) and Arbitrage Rebate Tax Expense of \$75,159 are considered investing rather than operating activities. The reconciliation includes the previously unreported change in Deferred Revenue and Advances of \$(71,852) and \$(104,162), respectively. Due to the restatement of operations income, the Cost of Issue Recovery of \$(67,160) was deleted from the reconciliation.

7. BOND DEFEASANCE

Using cash from the declaration of a dividend, cash available from the bond reserve and cash determined by the Montana State Compensation Insurance Fund to be in excess of the amount needed to pay claims occurring on or before July 1, 1990, the Board provided for the final retirement of \$97,885,000 in Payroll Tax Bonds (Workers' Compensation Program Series 1991). On October 3, 1996, the Board deposited \$99,384,056 with an escrow agent and invested in federal securities to provide for the future debt service payments until the bonds mature through June 1, 2020. The transaction met the requirements of a legal defeasance. The \$97,885,000 in Series 1991 Bonds maturing through June 1, 2020 were removed from the Montana State Compensation Insurance Fund accounting records in October 1996. The fiscal year 1997 net loss related to the bond defeasance totaled \$3,208,210. The net loss constitutes a final write off of the original bond discount and cost of issuance which was being amortized over the life of the bonds and a gain associated with the federal securities acquired for the defeasance.

Agency Response



MONTANA BOARD OF INVESTMENTS

Department of Commerce
555 Fuller Avenue PO Box 200126
Helena, Montana 59620-0126

Phone: (406) 444-0001
FAX: (406) 449-6579
TDD: (406) 444-2978
Rate Line: (406) 444-3557

November 14, 1996

NOV 15 1996

Scott A. Seacat, Legislative Auditor
Office of the Legislative Auditor
State Capital
Helena, Montana 59620

Dear Scott;

We compliment your staff for completing a complex audit of our financial operations in a professional manner. We are grateful for the services your staff provide in detecting problems that we may not be aware of.

The fact that there are no recommendations in this audit report is largely due to the dedication of our accounting staff and their supervisor, who have worked diligently to comply with all applicable accounting and internal control standards.

Sincerely,

Carroll South
Executive Director

